

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH : BANGALORE**

BEFORE SHRI NARENDER KUMAR CHOUDHRY, JUDICIAL MEMBER
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

ITA No. 299/Bang/2024
Assessment year : 2020-21

Mudur Vyavasaya Seva Sahakari Sangha Ltd., Mudur – 576 233. Kundapura Taluk, Udupi District. PAN : AAAAM 5489N	Vs.	The Income Tax Officer, Ward1 & TPS, Udupi.
APPELLANT		RESPONDENT

Appellant by	:	Shri Mahesh R. Uppin, Advocate
Respondent by	:	Shri Ganesh R. Ghale, Standing Counsel.

Date of hearing	:	21.03.2024
Date of Pronouncement	:	21.03.2024

ORDER

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the DIN & Order No.ITBA/NFAC/S/250/2023-24/1058924345(1) dated 20.12.2023 of the CIT(Appeals), National Faceless Appeal Centre, Delhi [NFAC], for the AY 2020-21.

2. The concise grounds of appeal are as under:-

“ 1. Whether both the below authorities were justified in denying the benefit of deduction u/s. 80P(2)(a)(i) of the Act to

the appellant in respect of its Business Profits of Rs. 12,70,793/- holding that the 'concept of mutuality' was dislodged in Appellant society even when the appellant society had 1,807 Regular Members, 168 Associate Members and 721 Nominal Members (as noted in para 6 — page 17 of appellate order) and appellant had not violated the cap of 15% meant for Associate members stipulated under the Proviso to Sec. 18 of KCS Act, 1959 and No restriction was placed in the Statute as to the maximum number of Nominal Members.

2. Was C.I.T. (A) justified in sustaining the addition for Interest on Investments of Rs. 20,51,081/- derived from SCDCC Bank [Investment income Rs. 22,50,081/- Less: Rs. 1,99,000/- relief given vide Para 8.2 of appellate order for interest earned from Co-op. Societies] holding the same as chargeable u/s. 56 of the Act.

3. Whether or not the interest on investments from SCDCC Bank that accrued to the appellant from its mandatory maintenance of fluid resources as required under its governing statute qualify for deduction u/s. 8P(2)(d) of the Act.

4. The impugned orders passed by both the below authorities run contrary to the established principles laid down by Hon. Apex Court and jurisdictional High Court.”

3. The brief facts of the case are that the assessee filed return of income on 09.11.2020 declaring total income of Rs.11,733. The return was processed u/s. 143(1). The case was selected for scrutiny under complete scrutiny. The AO issued statutory notices and the assessee uploaded details on ITBA. The AO noted that assessee has shown business income of Rs.35,70,873 and claimed deduction u/s. 80P(2)(a)(i) of Rs.35,09,140 and Rs.50,000 u/s. 80G of the Act. The AO referred to the scrutiny assessment order for AY 2018-19 and observed that Finance Act, 2006 inserted section 2(24)(viii) w.e.f. AY 2007-08 to include profits and gains of any business of banking

(including providing credit facilities) carried on by a co-operative society with its members as income. The AO noted that the society is having 3 categories of members. A class members participate in day to day affairs, B Class of members- is capital by State Government and C & D class members are (1) who does not possess A Class Shares (2) Non Members having deposits (3) Self-help Group, Commission Agents, individual Business, other businessmen etc. have no role in the management of society, have no voting rights & no entitlement for share in the assets or profits. The nominal members were more than 15% and there was violation of section 18 of the Karnataka Co-operative Societies Act, 1959 [KCS Act]. The AO relying on Citizen Co-operative Society Ltd. (2017) 397 ITR (SC) issued notice proposing to disallow deduction u/s. 80P. After considering the assessee's submissions, the AO observed that the facts were similar to Citizen Co-operative Society Ltd. (supra). The AO held that principle of mutuality is missing in assessee's case. Regarding assessee's reliance on the judgment of The Mavilayi Service Co-op. Bank Ltd. (Civil Appeal Nos.7343-7350 of 2019 dated 12.01.2021, the AO noted that the Supreme Court in para 33 held as under:-

“The distinction between eligibility for deduction and attributability of amount of profits and gains to an activity is a real one. Since and profits and gains from credit facilities given to non-members cannot be said to be attributable to the activity of providing credit facilities to its members, such amount cannot be deducted.”

3.1. Further, the AO noted that assessee society is giving loans to its members (by whatever name called – member, nominal member or

associate member or any other name) and to non-members and earn income from them, then there is no need to ascertain the attributability of amount of profits and gains to both the activities separately as held by Supreme Court noted above. Since profit and gains from credit facilities given to non-members cannot be said to be attributable to the activity of providing credit facilities to its members, such amount cannot be deducted. From the computation furnished the AO noted that deduction u/s. 80P(2)(a)(i) of Rs.47,92,857 and u/s. 80P(2)(d) of Rs.19,92,621 and Rs.12,777 u/s. 80P(2)(c) was claimed by the assessee and entire interest were shown under the head income from other source, accordingly AO disallowed entire deduction totaling to Rs.67,98,255.

3.2 Further from the detail furnished it was noted that the assessee has received interest from Co-operative Banks and Scheduled Banks of idle funds on its investments which are immediately not required for lending to its members. The assessee submitted its reply on 31.12.2020 stating that the interest received from long term deposits with co-operative banks and co-operative society and from scheduled bank is business income and assessee is eligible for deduction u/s 80P(2)(a)(i). Due to oversight it was claimed u/s 80P(2)(d) & 80P(2) (c). Considering the entire submissions the deduction claimed u/s 80P was denied and assessed income at Rs. 35,20,873/-.

4. Aggrieved from the above order, the assessee filed appeal before the CIT(Appeals). The CIT(Appeals) after considering the submissions

of the assessee noted that as per the bye-laws, deposits are acceptable only from members. This apart, Class C & D Members cannot be treated as members and substantial amounts are given as loans to these members also. Then, consequently, substantial amount is received/receivable by the assessee society as interest on these loans. In simple terms, a substantial portion of this amount is a consolidated amount of interest receivable from non-members. The part of funds as statutory deposit in banks has nothing to do with the determination of taxability of interest income derived from such statutory deposits. He observed that the Supreme Court in the case of Southern Technologies Ltd. [2010] 187 Taxman 346 (SC) held that the RBI directions to have statutory deposits has no overriding effect on the provisions of income tax. Such interest cannot be termed as interest earned against the deposit made with other cooperative societies, hence interest u/s. 80P(2)(d) is also not allowable. Therefore, he held that AO rightly made disallowance of deduction u/s 80P(2)(a)(i) and partly allowed deduction u/s 80P(2)(d) held that interest income of Rs.1,99,000 earned by assessee on deposits with other co-operative societies is allowable and directed the AO to allow the same.

4.1 Regarding the balance of interest income earned on account of deposits made with co-operative banks and commercial banks, the CIT(Appeals) observed such income in its nature is income from other sources taxable u/s. 56 and cannot be categorized as profits and gains of business of the assessee and will not fall within the ambit of principle of mutuality. Reliance was placed in the judgment of

Supreme Court in the case of Mavilayi Service Co-op. Bank Ltd. (Civil Appeal Nos.7343-7350 of 2019, Bangalore Club Bangalore Club [29 taxmann.com 29 (SC)] and Totgar's Co-operative Sale Society [2010] 188 Taxman 282 (SC). Hence the CIT(Appeals) held that such interest income earned from deposits with co-operative bank other than co-operative society is not entitled to deduction u/s. 80P(2)(a)(i) or 80P(2)(d) of the Act. Against the order of the CIT(Appeals), the assessee is in appeal before the Tribunal.

5. The Id. AR reiterated submissions made before the lower authorities and submitted that assessee is eligible for deduction u/s 80P(2)(a)(i) as per judgment of Hon'ble Apex Court in Mavilayi Service Co-op. Bank Ltd. [2021] 123 taxmann.com 1 (SC) wherein it is held that primary agricultural credit societies are entitled to the benefit of deduction u/s. 80P(2)(a)(i) of the Act on interest income earned from lending to members including nominal members. He submitted that interest income received on assessee's investments to another co-operative society are also eligible for deduction u/s. 80P(2)(d) because the co-operative banks are primarily co-operative societies as specified in section 80P(2)(d). He further submitted that the Id. CIT(A) has not considered the judgment in the case of Tumkur Merchants Souharda Credit Co-op. Ltd. reported in 55 taxmann.com 447 and the ITAT decision in Totgars Co-operative Sale Society in ITA No.376 to 379/Bang/2023 wherein interest income earned from investment in co-operative bank by multipurpose co-operative society is held eligible for deduction u/s. 80P(2)(d) of the Act. He further

submitted that the assessee is a primary agricultural co-operative society engaged mainly in the business of providing credit facilities to its members and providing financial aids as well as agricultural implements, seeds, fertilizers, pesticides etc. The assessee has earned interest on investments out of its operational fund used in business of lending to its members and not by investing surplus funds in short term deposits. The Id. CIT(A) has wrongly applied the judgment of Hon'ble Apex Court in the case of Totgars Co-operative Sale Society [2010] 322 ITR 283 and not considered that investment in co-operative bank is a statutory requirement under Karnataka Co-operative Societies Act, 1959. Hence it is attributable to carrying on of business and society is eligible for deduction u/s. 80P(2) of the Act. He further submitted that interest income earned should not be taxed under the head income from other sources and it should be considered as business income. Even the assessee has not been granted deduction u/s. 80P(2)(d). The Id. CIT(A) has also not decided the issue in the light of Hon'ble Supreme Court judgment in the case of Kerala State Cooperative Agricultural and Rural Development Bank Ltd. in Civil Appeal No.10069/2016, order dated 14.09.2023 in which it has been held that co-operative bank is a co-operative society which is registered under Kerala Co-operative Societies Act and it is not a bank per se governed by RBI.

6. The Ld.DR relied on the order of the Ld.CIT(A) and he submitted that the interest income received by the assessee is not to be considered as a business income since the Hon'ble Jurisdictional High Court of Karnataka has settled this issue in the case of Totgars' Co-

operative Sales Society Ltd. reported in (2017) 395 ITR 611 (Karnataka) dated 16.06.2017.

6.1 The Id. DR also submitted that the assessee has violated the principle of mutuality and relied on the judgment of Hon'ble Apex Court in the case of Citizen Co-operative Society Ltd. reported in (2017) 397 ITR 1 (SC). Accordingly the assessee is not eligible for deduction as observed by the lower authorities u/s 80P(2)(a)(i). He further submitted that in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd. KSCARDB vs. Assessing Officer, (2023) 154 taxmann.com 305 the Hon'ble Supreme Court has clearly held that if the payer bank holds licence from RBI for carrying out banking business, then the interest received from such bank is not eligible for deduction u/s. 80P(2)(d), though the co-operative bank may be primarily formed as co-operative society and that the activity of the entity should be seen. He submitted that the interest received from co-operative bank is governed by Banking Regulation Act, 1949.

7. Considering the rival submissions, we note that the assessee is registered under Karnataka Co-operative Society Act 1959. During the course of assessment proceedings, the AO asked to submit details as per notice u/s 142(1) and from the assessment order for the assessment year (AY) 2017-18 the AO noted as per Bye-laws that there are A class members, B class members, & C & D Class members. These C & D Class members are Non-Members. A class members participate in

day to day affairs, B Class of members- is capital by State Government and C & D class members are (1) who does not possess A Class Shares (2) Non Members having deposits (3) Self-help Group, Commission Agents, individual Business, other businessmen etc. have no role in the management of society, have no voting rights & no entitlement for share in the assets or profits.. The sec. 20(2)(a) of the Karnataka Co-operative Society Act denies any right to vote to a nominal or associate members. Further the Nominal/Associate members are not entitled to attend the general meetings of the society, not eligible to contest on election. As per bye-laws society collects Rs. 10/- from C Class Members & Rs. 500 for D Class Members as membership fee but there is no D Class members.

8. The AO further noted that A class members are 1738 & C Class members are 655 as on 31/03/2017. The non-members are 38% of the regular members. The Id. DR submitted that as per the Karnataka Co-operative Society Act sec. 18 amended by the Act 2014, the associated/nominal members should not exceed 15% of the regular members, if it exceeds, then it has to be regularized within the period of 6 months. The lower authorities have disallowed deduction on interest income received from providing credit facilities from all the members by following the judgment of Hon'ble Apex Court in the case of Citizen Co-operative Society Ltd., Hyderabad Vs. ACIT noted supra. The decision relied on by the Id. AR in the case of Mavilayi Service Co-operative Bank Ltd., (supra) is under Kerala Co-operative Societies Act in which it has been held that proportionate deduction

u/s. 80P(2)(a)(i) should be granted to the assessee from the interest income received from providing credit facilities to its members but not from the non-members. The Para 33 of the said judgement says as under:-

“.....Once it is clear that the co-operative society in question is providing credit facilities to its members, the fact that it is providing credit facilities to non-members does not disentitle the society in question from availing of the deduction. The distinction between eligibility for deduction and attributability of amount of profits and gains to an activity is a real one. Since profits and gains from credit facilities given to non-members cannot be said to be attributable to the activity of providing credit facilities to its members, such amount cannot be deducted.”

9. The ratio decided in this para is very much applicable for computing the income attributable to the business of the assessee among the members and non-members. The assessee is governed by Karnataka Co-operative Societies Act, 1959 and assessee has to follow section 18 (amended) Act of 2014. We noted that there is unequal rights among the A, B & C&D Class Members, accordingly the assessee is not eligible for deduction u/s 80P(2)(a)(i) of the Act on the interest income received from its C & D Class members as they are not members as per bye laws. Accordingly we remit this issue to the AO for fresh consideration and determination of the interest received from members and non-members from providing credit facilities and decide the issue as per law. The assessee is directed to produce the quantum of interest income received from providing credit facilities from A & B- Class members(regular members) and the AO shall grant deduction on such interest income u/s 80P(2)(a)(i) of the Act and rest

interest income from C & D Class members (as per bye-laws they are not members) are to be disallowed. Accordingly this issue is partly allowed.

10. Further in respect of deduction u/s 80P(2)(d), considering the rival submissions, we note that here the issue is that whether the assessee is eligible to claim of deduction u/s. 80P(2)(a)(i) and/or 80P(2)(d) on the interest income earned on its investments amount made with District co-operative banks. The Ld.CIT(A) has not accepted the claim of the assessee by relying on the judgment of Hon'ble Karnataka High Court in case of Totgars' Co-operative Sales Society Ltd. (supra) and Hon'ble Apex Court in the case of Citizens Co-operative Society Ltd. noted supra. During the course of hearing, the Ld.AR of the assessee relied on the Circular No. 18/2015 dated 02.11.2015 and submitted that as per the provisions of the Karnataka Co-operative Societies Act, the assessee is required to maintain SLR from the deposits received from the members and has to invest 100% from the general reserve and 25% from the deposits collected from members. Accordingly, assessee has invested in the fixed deposits. As per the circular, the income received from the investments should be treated as business income u/s. 28 and assessee is eligible to make a claim of deduction u/s. 80P(2)(a)(i) as business income. Further, the assessee also submitted that the investments were made in co-operative banks which are co-operative society. It is submitted by the Id. AR that interest received on such investments are to be allowed for

deduction u/s. 80P(2)(d). In support of his argument, the assessee relied on the following decisions:

- (i) Mavilayi Service Co-op. Bank Ltd. [2021] 123 taxmann.com 1 (SC).
- (ii) Tumkur Merchants Souharda Credit Co-op. Ltd. reported in 55 taxmann.com 447.
- (iii) ITAT decision in Totgars Co-operative Sale Society in ITA No.376 to 379/Bang/2023.
- (iv) Guttigedarara Credit Co-op. Society Ltd., Mysore, ITA 29/2015
- (v) Honnali Credit Co-opp. Society Ltd. ITA No.2752 & 2753/Bang/2017.
- (vi) Trapaj Vibhageeya Khet Udyog Mal Rupantar Food Processing Sahakari Mandali Ltd. v. DCIT, Cir. 2, Bhavnagar.

11. We note from plain reading of Circular No. 18/2015 dated 02.11.2015 it is applicable to those co-operative societies / co-operative banks in which the Banking Regulation Act, 1949 applies. During the course of hearing the assessee was asked to submit the requirement of SLR as per Karnataka Cooperative Societies Act and the quantum and period for calculating SLR, the assessee was unable to give reply. Rule 23 of the Karnataka Co-operative Societies Rules states that reserve fund belongs to the society and is intended to meet the unforeseen losses. Further if the cooperative society wants to invest reserve fund or any portion thereof for any other purpose as prescribed under section 58 (a) to (d) of the Karnataka Co-operative Societies Act permission is to be taken from the Registrar of Co-operative Societies.

Therefore the argument of the assessee that interest income on such investment is operational income is rejected. Even if the maintainability of SLR requirement is out of internal fund/external funds then no deduction shall be allowed u/s. 80P(2)(a)(i), since the interest income received on such investments from co-operative banks is not attributable to main business of the appellant. The issue regarding the word “attributable” has been discussed elaborately by the Hon’ble Apex Court in the case of M/s Totgar’s Co-operative Sales Society (2010) reported in [2010] 188 Taxman 282 (SC) where it is held by the Hon’ble Supreme Court that the deduction u/s 80P is available only to the income which is attributable to the business operation. Since the interest income received by the appellant was not attributable to the main business of the appellant the same is not allowable as deduction u/s 80P(2)(a)(i) of the Act.

12. We note from the submissions of the Id. AR that the assessee has invested in commercial bank as well as in co-operative banks and earned interest thereon. Section 80P(2)(d) describes that if the assessee has received interest from the co-operative society, then the assessee is eligible for claim of deduction on such interest received. In the judgment of Hon’ble Apex Court in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd. (KSCARDB) vs. The Assessing Officer, Trivandrum & Ors. (2023) 154 taxmann.com 305 (Supreme Court) it has been discussed in detail the definition of co-operative banks and co-operative society. If the payer bank falls under the definition of co-operative bank/ bank in the light

of the judgment of Hon'ble Apex Court then the assessee is not eligible to get deduction u/s. 80P(2)(d) on such interest income received from co-operative banks. We note that the assessee has also received interest from co-operative banks which is governed by the Banking Regulation Act of 1949 and this argument of the Id. DR has not been denied by the Id. AR of the assessee. The Section 80P(2)(d) describes that if the assessee has received interest/dividend from the co-operative society, then the assessee is eligible for claim of deduction on such interest/dividend and the Id. CIT(A) has allowed of Rs. 1,99,000 on such interest, however we note that the assessee has received interest from co-operative bank but it is not clear whether the interest payer (co-operative bank) is a bank and registered with Reserve Bank of India and holding licence from RBI for carrying out banking business as per RBI Act. In addition, the judgment of Hon'ble Apex Court in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd. KSCARDB vs. The Assessing Officer, Trivandrum & Ors. (supra) in which it has been discussed in detail the definition of co-operative banks and co-operative society. If the payer bank falls under the definition of co-operative bank in the light of the judgment of Hon'ble Apex Court then the assessee is not eligible to get deduction u/s. 80P(2)(d) on such interest income received from co-operative banks, therefore this issue is also remitted back to the Ld.AO for verification of interest received from co-operative bank in above terms. If AO finds that the co-operative bank is carrying its banking

business activities in the light of the above judgment, the deduction u/s. 80P(2)(d) on such interest income should not be granted.

13. We further note that the assessee has received interest from other co-operative banks/commercial banks on its investments. The revenue authorities have considered the entire interest as income from other sources u/s. 56 including the interest received from co-operative bank and no expenses u/s. 57(iii) has been allowed to the assessee for earning of such income. While calculating the income, the net income should be considered as taxable income after reducing the expenditure incurred towards earning of such income. Therefore relying on the judgment of Hon'ble Jurisdictional High Court in case of Totgars' Co-operative Sales Society Ltd. vs ITO Sirsi, reported in (2015) 58 taxmann.com 35 (Karnataka), the assessee is eligible for claim of its cost of funds on the interest income received from banks. Reliance is also placed on the judgment of Co-ordinate Bench of the Tribunal in case of The West Coast Paper Mill Employees Souhardha Credit Co-op. Ltd. Accordingly, the assessee is directed to provide the details of cost of funds before the assessing officer. Therefore for allowing cost of funds, we are remitting this issue to the assessing officer for determining the cost of funds for earning entire interest income from bank (co-operative bank and scheduled bank).

14. In the result, the appeal of the assessee is partly allowed for statistical purposes.

Pronounced in the open court on this 21st day of March, 2024 as per Rule 34 of Income Tax (Appellate Tribunal) Rules, 1963.

Sd/-

(NARENDER KUMAR CHOUDHRY)
JUDICIAL MEMBER

Sd/-

(LAXMI PRASAD SAHU)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 14th May, 2024.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. Pr. CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.