

**IN THE INCOME TAX APPELLATE TRIBUNAL
VISAKHAPATNAM BENCH, VISAKHAPATNAM**

**BEFORE SHRI V. DURGA RAO, HON'BLE JUDICIAL MEMBER &
SHRI D.S. SUNDER SINGH, HON'BLE ACCOUNTANT MEMBER**

**ITA No. 510/VIZ/2014
(Asst. Year : 2010-11)**

And

**ITA No. 160/VIZ/2017
(Asst. Year : 2011-12)**

The Jampeta Co-operative Urban Bank Ltd., Jampeta, Rajahmundry. vs. ACIT, Circle-1, Rajahmundry.

PAN No. AAAAT 4048 E
(Appellant)

(Respondent)

Assessee by : Shri G.V.N. Hari, Advocate.

Department By : Shri S. Ravi Shankar Narayan, Sr.DR

Date of hearing : 02/05/2018.

Date of pronouncement : 28/05/2018.

ORDER

PER V. DURGA RAO, JUDICIAL MEMBER

These are the appeals filed by the assessee against the order of Commissioner of Income Tax (Appeals), Visakhapatnam, dated 28/07/2014 for the Assessment Year 2010-11; and Commissioner of Income Tax (Appeals)-2, Guntur, dated 06/01/2017 for the Assessment Year 2011-12. Since facts and issues are common,

clubbed and heard together and disposed of by way of this consolidated order for the sake of convenience.

ITA No.510/VIZ/2014

2. Facts of the case, in brief, are that assessee is a cooperative society, engaged in banking business, filed its e-return of income on 01/10/2010 by declaring total income of Rs. 42,04,203/-. The same was processed under section 143(1) of the Income Tax Act, 1961 (hereinafter referred to as 'Act'). Subsequently, case of the assessee was selected for scrutiny and assessment is completed under section 143(3) of the Act. During the course of assessment proceedings, the Assessing Officer has made the addition in respect of 'interest on share capital' and 'gratuity fund'. The assessee carried the matter in appeal before the Id. CIT(A), who confirmed the order of the Assessing Officer.

3. Against the order of the Id. CIT(A), the assessee has raised the following grounds of appeal:-

1. *The order of the learned Commissioner of Income Tax (Appeals) is contrary to the facts and also the law applicable to the facts.*
2. *The Learned Commissioner of Income Tax (Appeals) is not justified in upholding the addition of Rs.31,94,377/- made by the assessing officer towards disallowance of interest on share capital.*
3. *The Learned Commissioner of Income Tax (Appeals) is not justified in confirming the disallowance of premium of Rs.2,23,178/- paid to LIC of India towards Group Gratuity scheme.*

4. *Any other ground that may be urged at the time of appeal hearing."*

4. Ground No.1 & 4 are general in nature, no adjudication is required and therefore, same are dismissed.

5. Ground No.2 relates to disallowance of interest on share capital. In the assessment order, the Assessing Officer has noted that the assessee had a share capital of Rs. 2,42,41,009/- and paid interest on share capital to its members at Rs. 31,94,377/- and debited interest at 15%. The Assessing Officer further noted that the assessee-society can pay interest or dividend at a minimum rate at 6%. It was contended before the Assessing Officer that there was no maximum ceiling limit prescribed in the said Act for payment of interest which was not accepted by the Assessing Officer. The Assessing Officer asked the assessee to clarify as to why interest was paid to the members instead of dividend, for which it was explained that the bank can grant either interest or dividend, but both cannot be done. The assessee before the Assessing Officer relied on the decision of the ITAT, Visakhapatnam Bench in the case of The District Cooperative Urban Bank Ltd., Visakhapatnam. The Assessing Officer by relying on the decision of the Id. CIT(A) in the case of The Aryapuram

Cooperative Urban Bank Ltd., for the Assessment Year 2009-10, disallowed the interest on share capital of Rs. 31,94,377/-.

6. On appeal, Id. CIT(A) confirmed the order of the Assessing Officer by observing as under:-

"5.1.3 I have carefully considered the submissions. I find that identical issue with same set of facts was considered in the case of The Aryapuram Co-op. Urban Bank Ltd. for A.Y. 2008-09 wherein it was held by the undersigned as follows:-

"8.4.9. As contended, the appellant is governed by the provisions of AP Co-operative Societies Act and not by the AP Mutually Aided Co-operative Societies Act. The decision rendered by the Hon'ble ITAT, Visakhapatnam in the case of Visakhapatnam Co-op Bank Ltd. would not be applicable as it was rendered with reference to the interpretation of section 16 of the AP Mutually Aided Co-operative Societies Act. It is pertinent to note that sec.45 of the AP Co-operative Societies Act which deals with 'Disposal of Profit' only provide for payment of dividend and not of interest However, Rule 36(5)(d) of the Act provided for payment of dividend or interest not less than 6% on share capital. The appellant bank had passed a resolution for payment of interest at 15% It is seen from the resolution that the bank has decided to make payment of interest in lieu of dividends, to reduce its tax burden on account of withdrawal of deduction under sec SOP of the IT Act by the legislature from 2007 onwards instead of payment of at 15% as In earlier years, interest has been paid at 15% for the subject year. It is clear that the payment has been made in lieu of dividends, and as such it amounts to application of profit and not a charge on profit Therefore, the AL. is directed to disallow the claim of Rs 77,63,806/- and add it to the total income This issue is disposed off accordingly"

5.1.4 The above findings and reasons would apply to the facts of this case also I As a result, the disallowance made by the AO is confirmed.”

7. Ld. counsel for the assessee has submitted that the present issue is squarely covered by the decision of the coordinate bench of the tribunal in the case of **ACIT Vs. Visakhapatnam Cooperative Bank Ltd.** in ITA No. 05/Vizag/2011, dated 29/08/2011. He also relied on the order of the coordinate bench of the tribunal in the case of **Visakhapatnam Cooperative Bank Ltd. vs. ACIT** in ITA No. 444/Vizag/2012, dated 30/09/2016 and also the decision of the ITAT, Hyderabad 'A' Bench in the case of **DCIT vs. Navabharath Co-op. Urban Bank Ltd.,** in ITA No.822/Hyderabad/2018, dated 09/10/2015.

8. On the other hand, Id. Departmental Representative supported the orders of the authorities below.

9. We have heard both the parties, perused the material available on record and gone through orders of the authorities below.

10. The only issue for our consideration is whether the interest on share capital paid by the assessee-bank is allowable or not. According to the Id. CIT(A), the interest payment made by the

assessee-bank is in lieu of dividends, as such it amounts to application of profit and not a charge on profit, therefore, it is not allowable. The same issue has been considered by the coordinate bench of the tribunal in the case of **ACIT Vs. Visakhapatnam Cooperative Bank Ltd.**, in ITA No. 05/Vizag/2011, dated 29/08/2011, wherein it has been held that interest paid on share capital goes to reduce the interest collected by the society from its members and it would not form part of the profit. The relevant portion of the order is extracted as under:-

"5. Now, we shall take up the appeal of the assessee. The solitary issue urged in this appeal relates to the eligibility of deduction of claim made under the head "Interest on share capital". The Learned CIT(A) has upheld the view of the Assessing Officer that the said payment is only an appropriation of profits and not a charge on profit.

6. However, according to the assessee, the said payment is not an appropriation of profit, but expenditure incurred by it in the ordinary course of business. The contentions of Learned A.R in this connection are summarized below:

(a) The assessee is a co-operative society carrying on banking business. It can lend or advance money only to its members. Accordingly the intended borrowers are required to subscribe to the share capital at a certain percentage of the loan amount. Only recently, vide circular no.UBD.BPD.(PCB). Cir.No.22/09.18.201 /2010-11 dated 15-11-2010, the Reserve Bank of India has exempted Urban Co-operative Banks fulfilling certain criteria, from the mandatory requirement of linking share capital to the borrowing norms.

(b) Thus the public subscribe to the share capital of the co-operative societies as a condition for obtaining loan, where as in the case of limited companies, the public subscribe to the equity share capital as an investment with the expectation of appreciation of share values. Further, in the case of co-operative society, a member can withdraw the share capital on ceasing to be a member and such kind of refund of share capital is not permissible

in the case of limited companies. Hence there is wide variation in the purpose and characteristics of the "share capital" in the hands of co-operative societies and limited companies. In the instant case, clause 42 of the Bye-Laws of the assessee society prescribes the rules for linking share capital to the borrowers.

(c) Since the borrowers are compelled to subscribe to the share capital, the nature of their contribution is akin to making of margin money deposits and hence the interest paid on the share capital should be treated as expenditure.

(d) Section 16(1) of the A.P. Mutually aided co-operative societies Act, 1995 provides for the disposal of surplus. This section mandates for the payment of interest on share capital not exceeding the rate of interest paid by scheduled banks. Hence there is mandatory requirement for payment of interest on share capital. Clause 46 of the Bye-Laws of the assessee also provides for making the said payment.

*(e) The Government of Andhra Pradesh has issued Guidelines for framing Bye-Laws of a Co-operative society, in which the object behind payment of interest on share capital is explained as under:
"Nonetheless, it should be our endeavour to protect our members' share capital from inflation, and if possible, to pay an interest on it equal to the maximum rate that commercial banks pay on fixed deposits. In early years, however, we may be able to pay only a nominal rate of interest, if any"*

Thus the object of payment of interest on share capital is only to keep the monetary value of the share capital in tact for the share holders, which is similar to the objective of keeping money in deposits with the bank. Hence such a payment is expenditure in the hands of the co-operative society.

(f) The Income tax Act permits deduction of interest paid to the partners in the case of partnership firms, however, subject to the conditions prescribed under section 40(b) of the Act. The partners are akin to the members in the case of "Co-operative societies". Further u/s 40(ba) of the Act, the interest paid to the members of an "Association of Person" is not allowed as deduction. However the "Co-operative societies" are specifically exempted from the definition of "Association of Persons" in section 40(ba), meaning thereby the Income tax Act does not debar deduction of payment of interest to the members of a co-operative society.

(g) The interest expenditure is allowed under section 36(1)(iii) of the Act. The said section states that the amount of interest paid in respect of capital borrowed for the purposes of the business or profession shall be allowed as deduction while computing the income from business. The Hon'ble Supreme Court in the case of Munjal Sales Corporation Vs. CIT (2008)(298 ITR 298) has observed that section 40(b)(iv), which allows payment of interest

to partners, have to be read along with section 36(1)(iii) of the Act. Hence both section 36(1)(iii) and section 40(b)(iv) of the Act go together.

(h) The term "Capital borrowed" signifies that there is a liability to repay the capital so borrowed. In the case of *Pepsu Road Transport Corporation Vs. CIT (1981)(130 ITR 18)(P&H)*, the share capital provided by the Central and State Government was not treated as "borrowed capital" only for the reason that there was no obligation to refund the capital so provided. However, in the case of co-operative societies, there is a liability to repay the share capital when the concerned member ceases to be a member. Hence "Share capital" in the hands of co-operative societies should be treated as "Borrowed Capital".

(i) In the case of *Jamshedpur Motor Accessories Stores Vs. CIT (1974)(95 ITR 664)*, the Hon'ble Patna High Court has held that the payment of share of profit to the financiers in lieu of interest is not uncommon and hence, if such a payment was made on the ground of commercial expediency, the same is allowable as deduction.

(j) In the case of *CIT Vs. T.T.D Co-operative Stores Ltd., (1998)(232 ITR 109)(A.P)*, the rebate to be given to its members was ascertained only at the end of the year at the time of making up of accounts. The revenue treated the said payment as appropriation of profit. However, the Hon'ble Andhra Pradesh High Court has held that the rebate so given is not part of profit at all but it goes to reduce the price of the goods sold by the co-operative society. Accordingly the rebate so given was allowed as a deduction. The same principles apply in the instant case also.

(k) The assessee has claimed the "interest on share capital" as expenditure in its profit and loss account, i.e. it is not shown as appropriation of profit.

(l) The interest so paid to the share holders is taxable in their respective hands. If the said payment is disallowed in the hands of the assessee, it would lead to double taxation.

7. The contentions of Learned D.R are summarized below:

(a) Under the Income tax Act, the payments made towards trading liabilities and which are "Charge on Profits" are only allowed as deduction.

(b) In the instant case, the interest is paid on "share capital". The said payment partake the character of "Dividend", which is an appropriation of profit.

(c) *The Partnership firms and Association of Persons are not legal entities. Under the Act, the payment of interest on capital is not allowed as a deduction except for the partnership firms.*

(d) *For the purpose of computing income under the Income tax Act, the provisions of the Income tax Act alone should be considered, i.e. the provisions of any other law are not required to be considered.*

(e) *The payment of interest on capital is prescribed u/s 16(1) of the A.P. Mutually aided Co-operative Societies Act, 1995 under the head "Disposal of Surplus", i.e. the said payment is only an appropriation of profit and not a charge on profit.*

(f) *The double taxation is not new to the Income tax Act. Under the old scheme of taxation of Partnership firms, the income of the firm was subjected to tax both in the hands of the firm as well as in the hands of the partners.*

(g) *There is no provision under the Income tax Act to allow deduction of payment of "Interest on share capital". Even under the Co-operative Act referred (Supra), such payment is permitted while deciding the manner of disposal of "surplus" only.*

(h) *The criteria of "repayment of share capital" alone cannot be taken support to categorise the impugned payment as "Interest on borrowed capital". Except in the hands of Limited Companies, the capital can be repaid in other forms of business organizations like Individuals, Partnership firms, Association of persons etc. Even in the case of Limited companies, they are permitted to purchase their own shares.*

(i) *The books of account maintained by the assessee either as per Co-operative Act or as per the guidelines of Reserve Bank of India does not decide the nature of payment. A payment can be allowed as expenditure only if it is a charge on profit or it was incurred to earn the income.*

(j) *The decision of Hon'ble Supreme Court in the case of Munjal Sales Corporation is concerned with the scope of provisions of sec.40(b)(iv) of the Act. The decision of Hon'ble P & H High court in the case of Pepsu Road Transport Corporation, the assessee there in was not a Co-operative society.*

8. *In the rejoinder, the Learned A.R submitted the disallowance provided u/s 40(ba) of the Act for interest paid to the members of Association of Persons does not apply to a co-operative society. He further submitted the term "Capital borrowed" used in sec. 36(1)(iii) of the Act should be given wide meaning.*

9. *We have heard the rival contentions and carefully perused the record. The dispute between the parties revolves around a narrow*

compass. The claim of the assessee is that the amount paid towards interest on capital is a charge on profit and hence allowable as deduction while computing the income of the assessee. However, the view of the department is that it is merely an appropriation of profit, since the said payment itself is decided only at the time when the decision on the manner of disposal of "surplus" of the year is taken, i.e., the said payment is decided only after the end of the financial year, that too after deciding the net profit of the year. It is interesting to note that both the parties have taken support of section 16(1) of the A.P. Mutually Aided Co-operative Societies Act, 1995, which reads as under:

"16. Disposal of Surplus:- (1) In any year a Co-operative Society shall allocate towards a deficit cover funds, deferred payment to members as patronage rebate in proportion to their use of the Co-operative Societies services and payment on share capital of interest not exceeding the rate of interest paid by scheduled banks, such percentage of the surplus arising from its business transactions in the previous year, as may be approved by the general body."

The case of the assessee is that it is mandatory to pay interest on share capital as the word "Shall" is used in the above said section and hence the impugned payment is a charge on profit. On the contrary, the view of the department is that the term "Surplus" is defined to mean the net excess of income over expenditure and hence the disposal of surplus signifies only "Appropriation of Profit".

10. However, in our view, the impugned issue needs to be analysed in a different angle. In this connection, we feel it pertinent to discuss about the decision of Hon'ble Jurisdictional Andhra Pradesh High Court in the case of CIT Vs. T.T.D Co-operative Stores Ltd, referred supra. The facts of the said case and the decision rendered by the Hon'ble Court are, in our view, relevant for resolving the issue before us. The assessee in the above said case is also a co-operative society engaged in the business of purchasing provisions and other goods which are sold mostly to the members of society. At the end of the year, after ascertaining the profits, the society declared rebate to its members. The assessee claimed the amount of rebate so distributed as a deduction in computing the income, but the said claim was disallowed by the revenue by holding that the rebate is nothing but an appropriation of its profit. The Tribunal, however, held that the rebate was to be related to the sale price of goods, which should be considered as a provisional price and the rebate is

related to the said provisional price. Accordingly it was that the amount of rebate should be allowed as a deduction in appropriating trading profits and not as expenditure incurred. This was so held for assessment years 1980-81 and 1981-82. However, for the assessment year 1982-83, the ITO allowed the deduction of rebate only to the extent of profits of business. This was confirmed by the Tribunal. On these facts, the High court proceeded to answer the following two questions:-

(a) Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the payment of rebate to its members was an expenditure wholly and exclusively incurred for the purpose of its business?

(b) Whether, on the facts and circumstances of the case, the Tribunal was correct in holding that the appropriation of profits to members under sec. 45 of the Co-operative Societies Act in the name of rebate was not distribution of profits to the members?

10.1 The Hon'ble Court approved the observations of the Tribunal that the scheme of rebate is that the price at which the goods were sold to the members was taken as a provisional price. When the rebate is given at the end of the year, the provisional price is reduced and the amount received by the society (sales amount) is itself taken at a reduced figure. The Court explained that the deduction goes to the trading account where the figure for sales will be reduced by the amount of rebate given. It is not a case where this deduction on business expenditure is made after ascertaining the gross profit.

10.2 With regard to the question whether the said payment of rebate is appropriation of profit, the High Court observed as under:

"The only objection is that this rebate is given at the end of the year after ascertaining the profit made during the year. That can be an occasion to find out whether the society has a surplus out of which a rebate could be given to the loyal customers. But even if the ascertainment is at the time of making up of the accounts, the actual rebate is related back to the date of sales and the sales figure is reduced in trading account. This is the view taken in *Armour Co-operative Marketing Society Vs. CIT (1987)(167 ITR 565)(AP)*."

10.3 The High court also took note of the following decisions of Hon'ble Supreme Court, which were referred to by the Tribunal and also the counsel for the assessee.

- (a) *Poona Electricity Supply Co. Ltd Vs. CIT (1965)(57 ITR 521)*
- (b) *Associated Power Co. Ltd Vs. CIT (1996) (218 ITR 195)*

We extract below the observations made by the Hon'ble Supreme Court in this regard:

"The Tribunal also referred to the decision of the Supreme Court in *Poona Electric Supply Co. Ltd.'s case (supra)* in support of their view. In that case, the Electricity Act provided for creating a reserve for the customers, in case the profit is more than the reasonable rate admissible for paying charges to the customers. The Supreme Court pointed out that if the rebate is given, it goes to reduce the price and, therefore, it is a case of the assessee receiving less amount as a profit."

10.4 However, in the case of *T.T.D. Co-operative Stores Ltd., supra*, the counsel for the revenue sought to distinguish the case of *Poona Electric Supply Co. Ltd. (supra)*, by stating that there is no such statutory direction to grant rebate in the case of *T.T.D. Co-operative Stores Ltd.* However, the High Court rejected the said contention of the revenue by observing as under:

"...but we are of the opinion that there is a clear decision to give rebate to those members of the society who have done large business as an incentive for the purpose of encouraging the co-operative movement and that the rebate is not to be given if there is a loss. Even in the recent decision in *Associated Power Co. Ltd. Vs. CIT (supra)*, the Supreme Court has reiterated the view after quoting the following passage from *Poona Electric Supply Co. Ltd's case (supra)*:-

"Under s. 10(1) of the IT Act, tax shall be payable by an assessee under the head "Profits and gains of business" in respect of profits and gains of any business carried on by him. The said profits and gains are not profits regulated by any statute, but profits in a business computed on business principles. They are business profits and not statutory profits. They are real profits and not notional profits. The real profit of a businessman under s. 10(1) of the IT Act cannot obviously include the amounts returned by him by way of rebate to the consumers under statutory compulsion. It is as if he received only from the consumers the original amount minus the amount he returned to them. In substance, there cannot be any difference between a business man collecting from his constituents a sum of Rs.Y in addition to Rs.X by mistake and returning Rs.Y to them and another businessman collecting Rs. X alone. The amount returned is not a part of the profits at all."

At the end the High Court observed as under:

"After considering various judgments, this Court was led to observe that the income tax was a tax on the real income, i.e. the profit arrived at on commercial principles subject to the provisions of the IT Act. The real profit could be ascertained only by making the permissible deductions. There was a clear cut distinction between deductions made for ascertaining the profits and

distribution made out of profits. In a given case, whether the outgoing fell in one or the other of the heads was a question of fact to be found on the relevant circumstances, having regard to the business principles. Another distinction that had to be borne in mind was that between the real profits and the statutory profits, that is, between the commercial profits and the statutory profits, the latter were statutorily fixed for a specified purpose. The Supreme Court emphasized the fact that the amount returned is not a part of profit at all. We, therefore, answer the questions in the affirmative and against the Revenue."

11. Now we shall turn to the facts prevailing in the instant case. The assessee is a co-operative society governed by "A.P. Mutually Aided Co-operative Societies Act, 1995. It carries on the business of banking, which involves mainly accepting deposits and other sources of funds and deploys them in advancing loans and advances. The assessee, being a co-operative society, is entitled to lend or advance money only to its members, i.e., any person who intends to borrow money from the assessee has to necessarily become a member of the assessee society. Clause 42 of Bye Laws of the assessee society prescribes the condition for "Linking Share holding with Loan/Limits and the said clause reads as under:

"42. LINKING SHAREHOLDING WITH LOAN/LIMITS:

- a) *A borrower should hold share capital at least 5 percent of his borrowings, if such borrowing is on an unsecured basic i.e. in the form of clean overdrafts, loan against one or two personal sureties and purchase/discount of clean bills and cheques.*
- b) *A borrower against tangible securities should hold share of the Bank to the extent of 2.50percent of his borrowings from the Bank except Gold loan borrowers.*
- c) *In the case of loans for small scale industrial units the linking of share capital might be fixed initially at one percent of the borrowings, to be raised in the course of next two years to 2.5percent.*
- d) *The share linking prescribed in the clause shall not however, apply to the loans granted to nominal member against pledge of gold jewels and silverware.*
- e) *Loans may however, be granted to non-members on the security of their deposits with the Bank".*

12. *The Co-operative societies in the province of Andhra Pradesh were initially governed by "The Andhra Pradesh Co-operative Societies act, 1964". Subsequently, the Andhra Pradesh State Government brought in a new Act named "The Andhra Pradesh Mutually Aided Co-operative Societies Act, 1995 to bring all the*

mutually aided co-operative societies under the new Act. The Statement of objects and reasons given for the new Act reads as under:

"An Act to provide for the voluntary formation of Co-operative Societies reliant business enterprises, based on thrift, self-help and mutual aid and owned, managed and controlled by members for their economic and social betterment and for the matter connected therewith or incidental thereto.

.....

Over the years, however, increased State participation in the financing and management of co-operatives has led to an unfortunate situation where co-operatives themselves, by and large, have started to perceive themselves not as member-controlled, member-sensitive business, guided by the universally accepted principles of co-operation, but as channels for Government subsidies and largesse. Sound and sustainable co-operative business, accountability, responsibility and self-reliance have taken a back seat.

....

On the other hand, the Government recognizes that there are some Co-operatives which may have some Government funds but are not dependent upon such funds or on Government assistance in other forms for their survival. These co-operatives need to be given greater autonomy and encouraged to pursue to legitimate interests of their members in an effective, self-reliant, responsible, accountable and democratic manner. The Government also recognizes that enabling legislation is required if ordinary people who expect to benefit from the co-operative form of business, without being dependent on Government resources, are to voluntarily promote and effectively develop services for themselves through their own Co-operative societies."

Thus it can be seen that the Object and reasons for bringing in a new legislation clearly recognizes and further gives stress to the necessity of developing co-operative societies as a member-controlled, member-sensitive business institution with the aim of achieving economic and social betterment of its members.

13. The Andhra Pradesh Government has issued guide lines for framing Bye-laws of a Co-operative society. In clause 30 of the said guide line, under the head "Interest on Share Capital", the Government has brought out the distinguishing features of "Share Capital" belonging to a limited company and a co-operative society in the following lines:

30. Interest on Share Capital

"In other forms of business, people invest with the hope that their investment will earn them the maximum possible returns. However, in a cooperative, members invest in order that they can set up services which they are in need of, from the provision of

which, they can get significant financial benefit. That is, they expect to benefit, not from direct return on the investment, but from the services provided by the cooperative, as a result of the investment.

Nonetheless, it should be our endeavour to protect our members' share capital, from inflation, and, if possible, to pay an interest on it equal to the maximum rate that commercial banks pay on fixed deposits. In early years, however, we may be able to pay only a nominal rate of interest, if any.

Section 16 of the Act itself does not permit us to give more interest than the banks and, therefore, we may want to include in our bye-laws that each year our general body will decide how much interest to give on share capital, such, however, that it does not exceed the maximum interest payable by scheduled banks, on fixed deposits".

Thus it is brought out clearly that the objective of subscribing to the share capital of a co-operative society is only to avail its services which the members themselves set up at the time when they are in need of so that they can get significant financial benefit. It is also stated in the guide line that section 14 of the new Act does not permit the Co-operative societies to raise share capital from Government or other non-members.

14. *Another distinguishing feature in the case of co-operative societies is that the share capital collected by a co-operative society from a person shall be refunded to him on his ceasing to be a member. This kind of refund of share capital is not permitted under the Companies Act. A share holder of a limited company has to transfer or sell the shares to any other person in order to realize his investment. Only recently, the Limited companies are permitted to purchase their own shares and such purchase cannot be equated to refund of share capital. In our view, the Co-operative Societies are permitted to refund the share capital in tune with its objective of providing services to its members only. In case of co-operative societies carrying on banking business, this provision enables it to lend or advance money only to its members.*

15. *From the foregoing discussions, it becomes clear that the mutually aided Co-operative Societies exist solely for the mutual benefit of its members. In the instant case, the assessee herein is required to lend or advance money only to its members, the object of which is that the benefits arising out of the business should be shared by the members only inter se.*

16. *In this back ground, if we look at the impugned issue, i.e. the interest paid on share capital, the ratio laid down by Hon'ble*

jurisdictional A.P. High Court in the case of CIT Vs. T.T.D. Co-operative Stores Ltd, (Supra), by following the Supreme Court's decisions referred (Supra), squarely apply to the facts of the instant issue. In the case of T.T.D. Co-operative Stores Ltd., (Supra), the members were sold goods at a particular rate and at the time of finalizing the accounts, a rebate was given to the members as a special incentive for increasing societies business. The claim of the revenue that the said rebate is only appropriation of profit was rejected by the Hon'ble High Court. The amount of rebate was treated as a reduction in the sales figure on the reasoning that

- (a) *the initial sales amount is considered as provisional price for the goods sold.*
- (b) *the rebate determined at the end of the year after ascertaining the profit made during the year is taken as the occasion to find out whether the society has a surplus out of which a rebate could be given to the loyal customers.*
- (c) *The said payment is backed by a clear decision to give rebate.*
- (d) *the actual rebate relate back to the date of sales and the sales figure is reduced in the trading account, even if the ascertainment of rebate is at the time of making up of the accounts.*
- (e) *the net profit is ascertained only after allowing the rebate, which goes to reduce the price at which members purchased the goods from the society, i.e. it is not a case where this deduction on business expenditure is made after ascertaining the gross profit.*
- (f) *There is distinction between the "real profits" and the "statutory profits", that is between the commercial profits and the statutory profits, the latter were statutorily fixed for a specified purpose. The income tax was a tax on the real income, i.e. the profit arrived at on commercial principles subject to the provisions of the IT Act.*

17. In the instant case, the business of the assessee society is banking business, wherein the "cash" forms the working commodity. The business of banking, inter alia, consists of taking deposits and advancing loan. In the instant case there is no dispute with regard to the fact that the loans are advanced only to the members and the borrower has to necessarily subscribe to the share capital of the assessee society in order to avail the loan facility.

18. The Hon'ble Supreme Court has explained the concept of "reduction of sales price" vis-à-vis the rebate by giving an example and the same was extracted by us in paragraph 10.4 (Supra). We

are of the view that the concept so explained by Hon'ble Supreme Court equally applies in the instant case also. We shall explain the same by giving an example. Suppose, a person, say Mr. X, approaches the assessee society for availing a loan of say, Rs.1,00,000/-. Let us assume that he is required to purchase shares worth Rs.5,000/- from the share capital of the assessee society. In that case, Mr. X will pay Rs.5,000/- to the assessee society and the assessee society will give a loan of Rs.1,00,000/- to Mr. X. In effect, Mr. X would receive a net amount of Rs.95,000/- only from the assessee society. Similarly, the net amount which goes out of the coffers of the assessee society is also `95,000/- only. However, the assessee society would charge interest at applicable rate on the loan amount of Rs.1,00,000/-, even though the net amount received by Mr. X is only Rs.95,000/-, i.e., that the assessee society is collecting interest, not only on Rs.95,000/-, being net cash out flow from its coffers, but also on the amount of Rs.5,000/- given by Mr. X as Share capital. At the end of the year, the assessee society may determine the amount of interest payable on the share capital out of the surplus. In the above said example, the assessee society would pay interest on the amount of Rs.5,000/- given as share capital. In that case, as per the ratio of the Hon'ble Supreme Court and the Andhra Pradesh High Court in the cases cited in para 10 and para 10.3 (Supra), the interest so paid on the share capital actually goes to reduce the amount of interest that was collected initially by the assessee society from Mr. X.

19. As stated earlier, it was held in those cases that the income tax is to be levied on the "real income", i.e. the profit arrived at on commercial principles subject to the provisions of the Income tax Act. Accordingly it was held that the rebate given to the members is not a part of profit at all. In the instant case also, it has to be held that the amount paid by the assessee as "interest on share capital", in the instant year, goes to reduce the gross interest collected by it from its members and it would not form part of profit at all. We order accordingly."

11. In the above referred case, the coordinate bench of the tribunal has given a specific finding that the assessee is a cooperative society, governed by the A.P. Mutually Aided Cooperative Societies Act, 1995. The above judgment has been

followed again in the case of assessee itself in ITA No. 449 & 450/Vizag/2012 dated 30/09/2016. The relevant portion of the order is extracted as under:-

"22. We have heard both the parties, perused the materials available on record and gone through the orders of the authorities below. In this case, the assessee has debited an amount of Rs.1,57,53,620/- towards interest on share capital. It was submitted that as per the section 16 of the A.P. Mutually Aided Cooperative Societies Act, 1995, it is an allowable expenditure. The A.O. has not accepted the explanation of the assessee and he has observed that the assessee has to allocate the interest on share capital only upon determination of the surplus arising from the business i.e. net profit. This is nothing but appropriation of profits but not an expenditure incurred for carrying on the business. The Ld. CIT(A) by following the decision of the coordinate bench of the Tribunal in assessee's own case for the assessment year 2007-08 in ITA No.5/Vizag/2011 & 19/Vizag/2011 for A.Y. 2007-08 vide order dated 29.8.2011 has directed the A.O. to delete the addition made by him. It is submitted across the bar that the very same issue in the assessee's own case is pending before the Hon'ble High Court. In view of the above, by following the coordinate bench of the Tribunal, in view of the doctrine of precedent, we dismiss this ground of appeal raised by the Department."

12. A similar issue has been considered by the ITAT, Hyderabad 'A' Bench in the case of Navabharath Co-op. Urban Bank Ltd., (supra) wherein the Tribunal has held that in the case of cooperative society, there is a liability to repay the share capital to its members concern once become a member. Therefore, the share capital in the hands of the cooperative society is to be treated as a borrowed capital. A similar issue was considered by the coordinate bench of the tribunal in the case of Visakhapatnam

Cooperative Bank Ltd., (supra) wherein it has been held that interest paid on share capital goes to reduce the gross interest paid by the assessee from its members and it would not form part of profit. Respectfully following the above decision of the coordinate bench of the tribunal in the case of Visakhapatnam Cooperative Bank Ltd., (supra) as also the decision of ITAT, Hyderabad 'A' Bench in the case of Navabharath Co-op. Urban Bank Ltd., (supra), we hold that interest paid on share capital goes to reduce the interest collected by the society from its members, would not form part of the profit. By considering the facts of the present case and also by following the decision of the coordinate bench of the tribunal in the case of Visakhapatnam Cooperative Bank Ltd., in ITA No. 05/Vizag/2011, dated 29/08/2011 & ITA Nos. 449 & 450/Vizag/2012 dated 30/09/2016; and also the decision of ITAT, Hyderabad 'A' Bench in the case of Navabharath Co-op. Urban Bank Ltd (supra), this ground of appeal raised by assessee is allowed.

13. Ground No.2 relating to disallowance of **gratuity fund** of Rs. 2,38,178/-. In the assessment order, the Assessing Officer has noted that an amount of Rs. Rs. 2,38,178/- was incurred by the assessee towards gratuity fund to LIC. Since the gratuity

fund/trust is not an approved gratuity fund under section 36(iv)(c) of the Act, the Assessing Officer disallowed the same.

14. On appeal, Id. CIT(A) confirmed the order of the Assessing Officer.

15. Ld. counsel for the assessee has submitted that for the Assessment Year 2011-12, the very same issue has been considered by the Id. CIT(A) and remitted the matter back to the Assessing Officer for fresh consideration, and he prayed that present issue may also be remanded to the Assessing Officer for fresh adjudication.

16. On the other hand, Id. Departmental Representative supported the orders of the authorities below.

17. We have heard both the sides, perused the material available on record and orders of the authorities below.

18. The case of the assessee is that an amount of Rs.2,38,178/- was paid by the assessee towards gratuity fund to LIC. The payment is not doubted by the department. The Assessing Officer and the Id. CIT(A) disallowed the same only on the ground that there is no approval. In the similar circumstances for the Assessment Year 2011-12, the Id. CIT(A) has directed the Assessing Officer to allow the deduction claimed, on production of

evidence by the assessee for the contribution made to the said fund, ultimately it came back to the employees gratuity fund approved by the Commissioner of Income Tax. Keeping in view of the above direction given by the Id. CIT(A), we are of the opinion that in the year under consideration also, the issue has to be decided in the similar lines. Therefore, we set aside the order passed by the Id. CIT(A) and remand the matter back to the Assessing Officer to decide the issue afresh in accordance with law keeping in view of the Assessment Year 2011-12. Thus, this ground of appeal raised by the assessee is partly allowed for statistical purposes.

ITA No. 160/VIZ/2017

19. The only issue raised in this appeal is with regard to disallowance of interest on share capital. A similar ground is raised in ITA No. 510/VIZ/2014 as ground No.2. In view of our decision in the above referred to appeal, this ground of appeal raised by the assessee is allowed.

20. In the result, appeals filed by the assessee in ITA No. 510/2014 is **partly allowed for statistical purposes** and in ITA No.160/VIZ/2017 is **allowed**.

Order Pronounced in open Court on this 28th day of May, 2018.

Sd/-
(D.S. SUNDER SINGH)
Accountant Member

sd/-
(V. DURGA RAO)
Judicial Member

Dated : 28th May, 2018.

vr/-

Copy to:

1. The Assessee - The Jampeta Co-operative Urban Bank Ltd., Jampeta, Rajahmundry.
2. The Revenue - ACIT, Circle-1, Rajahmundry.
3. The Pr.CIT, Rajahmundry.
4. The CIT(A)-2, Guntur & Id. CIT(A), Visakhapatnam
5. The D.R., Visakhapatnam.
6. Guard file.

By order

Easy & Speedy
Justice

(VUKKEM RAMBABU)
Sr. Private Secretary,
ITAT, Visakhapatnam.

