

**IN THE INCOME TAX APPELLATE TRIBUNAL
“SMC-C” BENCH : BANGALORE**

BEFORE SHRI JASON P BOAZ, ACCOUNTANT MEMBER

ITA No.1225/Bang/2019
Assessment year : 2016-17

M/s. Polali Service Co-operative Society Ltd., D.No.3/126, Post Polai, Bantwal – 574 284. PAN : AADAP 3126 C	Vs.	The Income Tax Officer, Ward – 2[3], Mangalore.
APPELLANT		RESPONDENT

Assessee by	:	Shri. V. Srinivasan, Advocate
Revenue by	:	Shri. Ganesh R. G, Standing Counsel

Date of hearing	:	05.08.2019
Date of Pronouncement	:	07.08.2019

ORDER

Per Jason P. Boaz, Accountant Member

This appeal by the assessee is directed against the order of CIT(A), Mangaluru, dated 27.03.2019, for Assessment Year 2016-17.

2. Briefly stated, the facts of the case are as under:-

2.1 The assessee filed the return of income for Assessment Year 2016-17 on 10.09.2016 declaring taxable income at Nil, after claiming deduction of Rs.36,93,687/- under section 80P(2)(a) of the Income Tax Act, 1961 (in short 'the Act'). The case was taken up for scrutiny for this Assessment Year and the assessment was concluded under section 143(3) of the Act vide order dated

28.12.2018, wherein the assessee's income was determined at Rs.36,93,690/-; in view of the Assessing Officer (AO) disallowing the assessee's claim for deduction under section 80P(2)(a)(i) of the Act and bringing to tax in the assessee's hands the amount of Rs.36,93,687/- under the head "Income from Other Sources". On appeal, the CIT(A), Mangaluru, dismissed the assessee's appeal vide the impugned order dated 27.03.2019.

3. Aggrieved by the order of the CIT(A), Mangaluru, dated 27.03.2019 for Assessment Year 2016-17, the assessee has preferred this appeal before the Tribunal wherein it has raised the following grounds:-

1. *The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of evidence, probabilities, facts and circumstances of the case.*
2. *The learned CIT[A] is not justified in upholding the denial of deduction claimed u/s.80P[2][a][i] of the Act amounting to Rs.36,93,687/- in respect of the profits earned by the appellant from the business of providing credit facilities to its members under the facts and in the circumstances of the appellant's case.*
3. *The learned CIT[A] erred in holding that the business of providing credit facilities to the members carried on by the appellant cannot be regarded as a business carried on by a co-operative society complying with the principles of mutuality since the appellant had admitted nominal members, who could neither vote nor were entitled to a share in the profits as per the bye-laws of the appellant and hence, the appellant was not entitled to deduction u/s. 80P[2][a][i] of the Act having regard to the rationale behind the judgement of the Hon'ble Supreme Court in the case of Citizens Co-operative Society reported in 397 ITR 1 [SC] under the facts and in the circumstances of the appellant's case.*
4. *The learned CIT[A] ought to have appreciated that the appellant cooperative society had no doubt admitted nominal members, which was permissible under the Karnataka Co-operatives Societies Act, 1959 and that there was no violation of any of the provisions of the Karnataka Co-operative Societies Act under*

which the appellant was constituted and therefore, the judgement of the Hon'ble Supreme Court relied upon in the case of Citizens Co-operative Society reported in 397 ITR 1 was distinguishable and wholly inapplicable to the facts of the appellant's case.

5. *Without prejudice to the above, the learned CIT[A] ought to have appreciated the alternate claim made by the appellant for allowance of deduction u/s. 80P of the Act with reference to the extent of income derived from advances given to members apart from nominal members, which was exempt under the principles of mutuality as held by the Hon'ble Bombay High Court **in the case of M/s. QUEPEM URBAN CO-OPERATIVE CREDIT SOCIETY LTD in ITA No. 22 to 24 of 2015 dated 17/04/2015** under the facts and in the circumstances of the appellant's case.*
6. *The learned CIT[A] ought not to have held that the income earned by the appellant from investments made in South Canara District Central Co Operative Bank, Vijaya Bank and Bantwal Taluk Agricultural Produce Marketing Society Limited to the extent of Rs. 50,74,988/- was liable for assessment as income from business and not under the head "Other Sources" under the facts and in the circumstances of the appellant's case.*
7. *The learned CIT[A] ought to have appreciated that the appellant had earned the interest income from investments statutorily required to be maintained under the Karnataka Co-operative Societies Act from out of the profits besides 25% of the total deposits as SLR with co-operative banks and 3% of the total deposits towards CRR and thus, the income earned therefrom ought to have been assessed as part of the business of the providing credit facilities its members and not under the head 'Other Sources' under the facts and in to:* circumstances of the appellant's case.*
8. *Without prejudice to the above, the learned CIT[A] ought to have appreciated that the cost of funds ought to have been allowed u/s. 57[iii] of the Act while assessing the interest income under the head "Other Sources" under the facts and in the circumstances of the appellant's case.*
9. *Without prejudice to the right to seek waiver with the Hon'ble CCIT/DG, the appellant denies itself liable to be charged to interest u/s 234-B of the Act, which under the facts and in the circumstances of the appellant's case deserves to be cancelled.*

10. For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs.

4. The issues that arise for consideration in this appeal by the assessee are as to whether the Revenue authorities were justified in holding that the assessee was not entitled to the benefit of deduction under section 80P(2)(a)(i) of the Income Tax Act, 1961 (in short 'the Act') on interest income earned and under section 80P(2)(d) of the Act in respect of interest received from Co-operative institutions. The Assessing Officer (AO) denied the claim of the assessee on the ground that interest income earned by making investment of surplus funds has to be assessed under the head "Income from Other Sources" and not income from business and since interest income is not assessed as business income, the claim for deduction under section 57 of the Act cannot be allowed. In upholding the above conclusions, the CIT(A), *inter alia*, relied on the decision of the Hon'ble Supreme Court in the case of The Totgar's Co-operative Sales Society Ltd., Vs. ITO 322 ITR 283 (SC) wherein the Hon'ble Supreme Court held that the benefit of deduction under section 80P(2)(a)(i) of the Act is only on income which is assessable under the head "Income from Business". Interest earned on investment of surplus funds not immediately required in short term deposits and securities by a Co-operative Society providing credit facilities to members or marketing agricultural produce to members is not business income but income from other sources and the society is not entitled to special deduction.

5. While learned AR relied on the decision of the Hon'ble Karnataka High Court in the case of Tumukur Merchants Souharda Credit Co-operative Ltd., 230 taxman 309 (Karn), the DR relied on a subsequent decision of the Hon'ble Karnataka High Court in the case of PCIT Vs. Totgars Co-operative Sale Society Ltd., 395 ITR 611 (Karn.). I have carefully gone through the said

judgment. The facts of the case before the Hon'ble Karnataka High Court was that the Hon'ble Court was considering a case relating to Assessment Years 2007-08 to 2011-12. In case decided by the Hon'ble Supreme Court in the case of the very same assessee, the Assessment Years involved was Assessment Years 1991-92 to 1999-2000. The nature of interest income for all the Assessment Years was identical. The bone of contention of the Assessee in AY 2007-08 to 2011-12 was that the deduction under Section 80P(2) of the Act is claimed by the respondent assessee under Section 80P(2)(d) of the Act and not under Section 80P(2)(a) of the Act which was the claim in AY 1991-92 to 1999-2000. The reason given by the Assessee was that in AY 2007-08 to 2011-12 investments and deposits after the Supreme Court's decision against the assessee Totgar's Co-operative Sale Society Ltd. (supra), were shifted from Schedule Banks to Cooperative Bank. U/s.80P(2)(d) of the Act, income by way of interest or dividends derived by a Co-operative Society from its investments with any other Co-operative Society is entitled to deduction of the whole of such interest or dividend income. The claim of the Assessee was that Co-operative Bank is essentially a Co-operative Society and therefore deduction has to be allowed under Clause (d) of Sec.80P(2) of the Act. The Hon'ble Karnataka High Court followed the decision of the supreme Court in The Totgars Co-operative Sales Society Ltd. (supra) and held that interest earned from Schedule bank or co-operative bank is assessable under the head income from other sources and therefore the provisions of Sec.80P(2)(d)of the Act was not applicable to such interest income. It is thus clear that the source of funds out of which investments were made remained the same in AY 2007-08 to 2011-12 and in AY 1991-92 to 1999-2000 decided by the Hon'ble Supreme Court. Therefore whether the source of funds were Assessee's own funds or out of liability was not subject matter of the decision of the Hon'ble Karnataka High Court in the decision cited by the learned DR. To this extent the decision of the Hon'ble Karnataka High Court in the case of Tumukur Merchants Souharda Co-operative Ltd. (supra)

still holds good. Hence, on this aspect, the issue should be restored back to the AO for a fresh decision after examining the facts in the light of these judgment of the Hon'ble Apex Court rendered in the case of The Totgars Co-operative Sale Society Ltd. (supra) and of Hon'ble Karnataka high Court rendered in the case of Tumukur Merchants Souharda Co-operative Ltd. (supra).

6. The AO will afford adequate opportunity of being heard to the Assessee and for filing details / evidence for the assessee to substantiate its case, before deciding the issue.

7. In the result, the assessee's appeal for Assessment Year 2016-17 is allowed for statistical purposes.

Order pronounced in the open court on this 7th day of August, 2019.

Sd/-
(JASON P BOAZ)
Accountant Member

Bangalore.

Dated: 7th August, 2019.

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| 1. Appellants | 2. Respondent |
| 3. CIT | 4. CIT(A) |
| 5. DR | 6. Guard file |

By order

Assistant Registrar,
ITAT, Bangalore.