

IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES “ C ” BENCH: BANGALORE
**BEFORE SHRI A.K. GARODIA, ACCOUNTANT MEMBER
AND
SHRI PAVAN KUMAR GADALE, JUDICIAL MEMBER**

ITA No.226/Bang/2020
(Assessment Year: 2016-17)

M/s. Rythara Seva Sahakara Sangha Niyamitha,
Hesaraghatta, Opp. BMTC Bus Stop,
Hesaraghatta MainRoad,
Bangalore-560 088
PAN AACAR1587N

....Appellant

Vs.

Income Tax Officer,
Ward 6(2)(5), Bangalore.

.....Respondent.

Assessee By:	Shri Nayaz Pasha, C.A.& ShriThippeswamy .C.A
Revenue By:	Smt. R. Premi, JCIT (D.R)

Date of Hearing :	01.07.2020
Date of Pronouncement :	.07.2020

ORDER

PER SHRI PAVAN KUMAR GADALE, JM :

The assessee has filed an appeal against the order of Commissioner of Income Tax (Appeals)-6, Bangalore passed u/s. 143(3) and u/s 250 of the Income Tax Act, 1961.

2. At the time of hearing, The Ld. AR submitted that there is a delay of 42 days in filing the appeal and the condonation petition with Affidavit was filed. On examination of the petition, we found there is a reasonable cause for delay and the LdDr has no serious objections. Accordingly, the delay is condoned and the appeal is admitted and heard.

3. The Concise grounds of appeal of the assessee are as under :

1. Interest income of Rs. 9,65,206, which is business income but treated as income from other sources

1.1 The facts of the case in the Totagar's Cooperative Society and the appellant in this case are completely different. The Hon'ble Supreme Court was dealing with a case where Totagar's was engaged in business of marketing of agriculture produce and was not engaged in business of providing credit facilities. It was also serving to public who were non-members.

1.2 The appellant is engaged in business of providing credit facilities in the form of short term, medium term and long term loan to its members. The appellant has not provided any loan to non members though its members include Nominal Members. The decision of Totagar's is not applicable in case of society engaged in business of providing credit facilities as also been held in following cases:

- a) **Income Tax Officer vs Tumkur Merchants Souharda Credit Co-operative Limited.**
- b) **Commissioner of Income Tax III, Hyderabad Vs Andhra Pradesh State Co-operative Bank Ltd., reported in (2011) 200 Taxman 220/12.**
- c) **This Honorable tribunal case No. ITA 2752 & 2753/Bang/2017, order dated 31.01.2018.**

2. Deduction for Business Profit disallowed as members include Nominal Members

2.1. The Appellant is engaged in business of supply agricultural inputs, seeds, fertilizer, chemical fertilizer, to farmers being members of society which include nominal members. The Appellant is a Co-Operative Society registered under the Karnataka State Co-Operative Societies Act. As per section 2(f) of the said Act, member includes Nominal members and Associate members.

2.2. The Assessing officer has relied upon the Honourable Supreme Court judgment in case of Citizen Co-Operative bank in disallowing the business profits, but the facts appellant's case is completely different from the said case. The Hon'ble Apex court in the aforementioned case specifically took note of the factual finding that the assessee therein cannot admit 'nominal members' and most of deposits were taken from such category of persons as they were not members as per provisions of MACS Act.

2.3. As for the Karnataka State Co-Operative Societies Act, which is applicable to the present case is concerned the definition of a 'member' as provided in section 2(f) includes a nominal member and the appellant relies on following decisions in support of its contentions.

- a) **U.P.Co-operative cane union vs Commissioner of Income Tax (1999) 237 ITR 574 (SC)**
- b) **Jalgaon District Central v UOI(2004) 265 ITR 243 (Bom)**
- c) **PCIT Vs M/s S-1308 Ammapet Primary Agricultural Co-Operative Bank Ltd**

4. The Brief facts of the assessee are that the assessee is a co-operative society registered as Association of Persons(AOP) engaged in the business of providing credit facilities to the members of the society and filed the Return of Income for the Asst. Year 2016-17 on 12.10.2016 with total income of Rs.3,01,750/-.The assessee's income includes income from house property, business income and interest income. The return of income was processed under Section 143(1) of the Act on 2.11.2016. Subsequently, the case was selected for scrutiny under CASS and e-Notice under Section 143(2) and 142(1) of the Act were issued. In compliance, the assessee has furnished copies of computation of income, Balance Sheet, Bank Statements, Bye-laws of the co-operative Society and other details electronically. The Assessing Officer has examined the details and observed that the assessee is a co-operative society engaged in the business of advancing of short term loans (agriculture loans for crop production and marketing of crops and advancing medium term loans for development of agricultural infrastructure) and has disclosed the rental income, profit on sale of agriculture commodities. And the exemption under Section 80P(2)(a)(i) of the Act was claimed. Further, the interest and dividend income has been disclosed under 'income other sources' and claimed

exemption under Section 80P(2)(d) of the Act. The Assessing Officer has issued show cause notice and found that the society has interest income on fixed deposits with Co-operative Banks and Karnataka State Co-operative Apex Bank Ltd. aggregating to Rs.9,65,206/-. The assessee society is providing credit facilities to members and accepts deposits from its members and surplus funds has been kept in fixed deposits in co-operative banks and is not eligible to treat the interest income under income from other sources. Whereas, the society has invested/deposited funds which are not required for business being surplus funds and interest on deposits cannot be considered as income from other sources and observed that the interest income is not covered under Section 80P(2)(d) of the Act and relied on the judicial decisions and disallowed the claim.

5. Further, the Assessing Officer dealt on the submissions, financial statements, Bye-laws submitted by the assessee and observed that the assessee has four categories of memberships in the co-operative society. The four categories are -

- i) Sadasyaru/Members : They are eligible for loans, voting rights and also eligible to share profits.
- ii) Saha Sadasyaru/Associate Members : They are eligible to purchase shares but no voting rights.

iii) Naama Maatra Sadasyaru/Nominal Members :They are not eligible to share the profits and no voting rights.

iv) Karnataka Sarkara / Government of Karnataka : Karnataka Government or any organization authorized by the Government of Karnataka can avail membership.

The Assessing Officer observed that the assessee society has accepted deposits from members and lend to its member, and also accepts deposits from nominal members and lend loans. Whereas,the nominal members do not have right to share in profits/dividends and has no voting rights. Accordingly, the Assessing Officer relied on the decision of Hon'ble Supreme Court in the case of Citizen Co-operative Society Ltd. Vs. ACIT 84 taxman.com 114 in respect of claim of deduction under Section 80P and the test of mutuality, and also there is no complete identity of its members and nominal members and hence the assessee society is not eligible for the claim of deduction under Section 80P(2)(d)of the Act and disallowed the claim and assessed the total income of Rs.31,37,551/- and passed the order under Section 143(3) of the Act dt.13.12.2018. Aggrieved by the order, the assessee has filed an appeal with the CIT(Appeals), whereas the CIT(Appeals) concurred with the action of the Assessing Officer and dismissed the appeal. Aggrieved by the order of CIT (Appeals), the assessee has filed an appeal with the Tribunal.

6. At the time of hearing, the ld. AR submitted that the CIT(Appeals) has erred in confirming the denial of deduction under Section 80P(2) of the Act and the decisions relied by the CIT(Appeals) are distinguishable. Further the society accepts the deposits and lends finances to its members and details of members of the society are available and also interest on deposits are exempted and supported his arguments with the decisions of the Hon'ble High Court and Tribunal and prayed for allowing the appeal. Contra, the ld. DR relied on the orders of the CIT (Appeals).

7. We heard the rival submissions and perused the material on record. The learned Authorized Representative emphasizing on the claim of deduction in respect of interest earned from the co-operative societies/Banks, whereas the Assessing Officer denied the claim of the assessee, observing that the interest earned on surplus funds are taxable and not eligible for deduction under Section 80P(2)(d) of the Act. We found that this disputed issue was considered by the co-ordinate bench in the case of *The Jayanagar Co-operative Society Ltd.* ITA No.3254/Bang/2018 where Tribunal observed at paras.4 & 5 as under:

“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.). We 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 cooperative 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).”

We found that the facts of the present case are similar to the decision rendered by the co-ordinate bench of the tribunal, in respect of chargeability of interest income under income from other sources or business income. We follow the judicial precedence and restore the disputed issue to the file of the CIT (Appeals) to consider the submissions of the assessee for fresh adjudication in light of the judicial decisions of Hon’ble Supreme Court in the case of Totgars Co-operative

Sale Society and Hon'ble Karnataka High Court decision of Tumkur Merchants C-operative Society and the assessee should be provided adequate opportunity of hearing and shall co-operate in submitting the documents and allow grounds of appeal of the assessee for statistical purposes.

8. On the second disputed issue, we found the Assessing Officer has denied the deduction under Section 80P(2)(a)(i) of the Act, as the assessee society accept the deposits from general public being Nama Matra Sadasyaru/Nominal Members and the identity was not established in respect of ordinary members and nominal members in the assessment proceedings. The contention of the Id. AR that the nominal members are the contributors for earning surplus and does not participate /share the surplus of the society and do not have voting rights. We found the co-ordinate bench of the Tribunal in the case of M/s. Kodavoor Vyavasaya Seva Sahakari Sangha Niyamitha & Others Vs. ITO (ITA No.707/Bang/2019 dt.26.08.2019) has dealt on the criteria of nominal members. We considered the observations of the co-ordinate bench at Para 5 of the order which is read as -

5. Similarly, on the issue of definition of the Member where Nominal Members are also eligible for benefits. The Member defined under the co-operative society Act bye-laws includes Nominal Member. We found Ahmadabad Bench of ITAT in ITA No.1328/Ahmd/2018 for Asst. Year 2015-16 in the case of Trapaj Vibhageeya Khet Udyog Mal Rupantar Food Processing Sahakari Mandali Ltd. Vs. DCIT (supra) at para 7 has held as under :

“ 7. We have heard Id.DR and gone through the record. We have also gone through case laws cited both the sides before Id.CIT(A). We find that fundamental facts which are not disputed by the Revenue authorities are that the assessee is a primary agricultural credit society registered under the Gujarat

Cooperative Societies Act, 1961. It is engaged in providing credit facilities to the farmers in the region of Bhavnagar district. As per the AO, members of the assessee-society consisted of two types viz. regular member and nominal members. It is the case of the Revenue that assessee is doing more business with nominal members than the regular member in order to earn more profit, which is against the law, and therefore, there is a break-down of principle of mutuality resulting disentitlement of exemption under section 80P. The Id.AO relied upon the judgment of Hon'ble Supreme Court in the case of Citizens Cooperative Society Ltd. (supra) to support his view. While the case of the assessee is that being a primary agriculture credit society, it is entitled for exemption under sub-section (4) of section 80P. Judgment of Hon'ble Apex Court relied upon by the Revenue is distinguishable on facts. In that case assessee was a cooperative society registered under Multi State Cooperative Societies Act, 2002, while in the present case, assessee is a primary agriculture credit society registered under Gujarat State Cooperative Societies Act. The Hon'ble Supreme Court disentitled the assessee from claiming exemption under section 80P due to violation of provisions of MACSA, under which it was formed, and most of the business of the assessee was with carved out category of persons without approval of Registrar of the Societies. Weighing point of view of both sides, we find that balance tilt in favour of the assessee. We find that by virtue of sub-section (4) of section 80P, the assessee is entitled for deduction under section 80P(2). Further, Income Tax Act does not define "member", nor has provided distinction between 'regular member' and 'nominal member' and therefore, its meaning and objects has to be understood in the context of definition given in the State Act. The Revenue authorities are trying to extrapolate the meaning of expression "Member" contrary to the spirit of the Act. It is evident from the definition of "member" provided in section 2(13) of the Gujarat Cooperative Societies Act that "Member" includes nominal, associate or sympathizer member. Therefore, in the present case, the nominal members are members as provided in the Act and that deposits received and loan advanced to the nominal cannot be treated as from non-members or from public and in the nature of banking business. That being so, then, an assessee engaged in primary agriculture activities and providing credit facilities and agriculture facilities to the farmer-members of a particular region, claim of deduction under section 80P(2) cannot be denied. It is not denied by the Revenue that the activities of the assessee society are of primary agriculture activities. Competent authority has also recognized the assessee as primary agriculture credit society. In the earlier assessment year also, Revenue has accepted this fact and allowed the claim of the assessee. Judgment of Hon'ble Supreme Court in the case of Citizens Co-operative Society Ltd. (supra) is distinguishable on facts. In that case, status of the assessee is that of co-operative bank, whereas assessee in the present case is a primary agriculture credit society and applicability of section 80P(2)(4) of the Act. Considering all these facts, we are not convinced with the reasoning and finding given by the Revenue authority in denying claim of the assessee under section 80P(2). We allow the claim of the assessee and direct the Id.AO to re-compute income of the assessee by allowing claim under section 80P(2)(4) of the Act."

Also in Tax Case Appeal No.882 and 891 of 2018 of Hon'ble Madras High Court in the case of The Prin. Commissioner of Income Tax Vs. S-1308 Ammapet Primary Agricultural Co-operative Bank Ltd. held in paras 11 to 18 as under :

11. We have elaborately heard the learned Senior Standing Counsel for the Revenue.

12. Admittedly, the assessee society is registered under the provisions of the TNCS Act. It defines the word 'members' under Section 2(16) to mean a person joining in the application for the registration of society and a person admitted to the membership after registration in accordance with the provisions of the Act, the Rules framed thereunder and the By-laws and includes an associate member. The expression 'associate member' is defined under Section 2(6) of the TNCS Act to mean a member, who possesses only such privileges and rights of a member and who is subject only to such liabilities of a member as may be specified in this Act, the Rules and the By-law.

<http://www.judis.nic.in>

13. Thus, the definition of the word 'members' includes an associate member and therefore, the Assessing Officer fell into an error in drawing a distinction between A Class members and B Class members. For the purpose of being entitled to a relief under Section 80P of the Act, all that is required is that the cooperative society should answer the description of a society engaged in carrying on the business of providing credit facilities to its member. Once the description is answered, then automatically, the benefit of Section 80P of the Act would stand attracted subject to the provisions contained in Sub-Section (2) of Section 80P of the Act.

14. Further, it is to be pointed out that in terms of Sub-Section (4) of Section 80P of the Act, which was inserted vide the Finance Act, 2006 with effect from 01.4.2007 i.e from the assessment year 2007-08, the 'primary cooperative agricultural and rural development bank' means 'a society having its area of operation confined to a taluk, the principal object of which is to provide for long term credit for agricultural and rural development activities'. What was excluded was the 'cooperative banks' and admittedly, the assessee society is a primary agricultural cooperative credit society and therefore, would be entitled to the benefit of Section 80P of the Act.

15. Further, for the assessment year 2014-15, the decision in the case <http://www.judis.nic.in> of Citizen Cooperative Society Limited was relied upon by the Revenue before the Tribunal, which, in paragraph 6.1 of its order dated 28.2.2018 for the assessment year 2014-15, extracted the operative portion of that judgment. In that case, the Hon'ble Supreme Court found that the society carried on certain activities, which were contrary to the provisions of the Andhra Pradesh Mutually Aided Cooperative Societies Act, 1995 and that they accepted deposits from third parties, who were not members in the real sense and were using those deposits to advance gold loans. Therefore, the Hon'ble Supreme Court pointed out that such an activity of the said society was that of a finance business and could not be termed as a cooperative society and that the loans, which were disbursed, were without the approval from the Registrar of Mutually Aided Cooperative Societies, Ranga Reddy District. The Hon'ble Supreme Court found that the said society was not entitled to deduction under Section 80P of the Act.

16. It is noteworthy to point out that the Hon'ble Supreme Court in the decision in the case of Citizen Cooperative Society Limited also observed that in the light of insertion of Sub-Section (4) to Section 80P of the Act by the Finance Act, 2006, such deduction should not be admissible to a cooperative bank and that if it is a primary agricultural credit society or a primary cooperative agriculture and rural development bank, the deduction would still be provided. <http://www.judis.nic.in>

17. In the preceding paragraphs, we have pointed out the definitions of the expressions 'members' and 'associate member' under the TNCS Act and held that an 'associate member' is also a 'member' in terms of Section 2(16) of the TNCS Act. Furthermore, the Assessing Officer himself found that the associate members are also admitted as members of the society. In such circumstances, the Assessing Officer fell into an error in not granting any relief to the assessee society, which was rightly granted by the CIT (A) as confirmed by the Tribunal. In addition to that, the Assessing Officer has not pointed out that loans have been disbursed to all and sundry in terms of the provisions of the TNCS Act and in terms of Clause (b) to Sub-Section (4) of Section 80P of the Act, the society has an area of operation, operates within the taluk and will provide long term credit for agricultural and rural development activities as well. The CIT (A) rightly granted the relief to the assessee as confirmed by the Tribunal. We do not find any good ground to entertain these appeals.

18. Accordingly, the above tax case appeals are dismissed. The substantial questions of law framed are answered against the Revenue.

We found in the present case, the nominal members are part of the society for earning surplus/income to the society. Accordingly, we set aside the order of the CIT (Appeals) on this issue and restore this disputed issue to the file of CIT(A) for fresh adjudication on the four categories of members and eligibility of nominal members under Karnataka State Co-operative Societies Act, 1959 and pass a speaking order. Further the assessee should be provided adequate opportunity of hearing and shall co-operate in submitting the information and allow the grounds of appeal of the assessee for statistical purposes.

8. In the result, appeal of the assessee is treated as allowed for statistical purposes.

Pronounced in the open court on the date mentioned on the caption page.

Sd/-

(A.K. GARODIA)
ACCOUNTANT MEMBER

Sd/-

(PAVAN KUMAR GADALE)
JUDICIAL MEMBER

Dated: 06.07.2020.

*Reddy GP

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| 1. The Appellant | 2. The Respondent |
| 3. CIT (Appeals) | 4. Prin. CIT |
| 5. DR, ITAT | 6. Guard File. |

By order

Assistant Registrar
Income-tax Appellate Tribunal
Bangalore