

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "A", BANGALORE**

Before Shri George George K, JM & Shri B.R.Baskaran, AM

ITA No.766/Bang/2018 : Asst.Year 2007-2008
ITA No.767/Bang/2018 : Asst.Year 2008-2009
ITA No.768/Bang/2018 : Asst.Year 2009-2010
ITA No.769/Bang/2018 : Asst.Year 2011-2012
ITA No.770/Bang/2018 : Asst.Year 2012-2013
ITA No.771/Bang/2018 : Asst.Year 2013-2014
ITA No.772/Bang/2018 : Asst.Year 2014-2015

M/s.Vijaya Bank Employees' Housing Co-operative Society Ltd. #999A, 1 st Floor, Vijaya Bank Layout, MSRS Nagar, Bilekahalli Bangalore – 560 076. PAN : AAAJV0301M.	v.	The Asst.Commissioner of Income-tax, Circle 10(1) Bangalore.
(Appellant)		(Respondent)

Appellant by : Sri.V.Chandrashekar, Advocate

Respondent by : Ms.Neera Malhotra, CIT-DR

Date of Hearing : 30.03.2021	Date of Pronouncement : 01.04.2021
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ORDER

Per George George K, JM :

These appeals at the instance of the assessee are directed against seven separate orders of the CIT(A), all dated 29.11.2017. The relevant assessment years are 2007-2008, 2008-2009, 2009-2010, 2011-2012, 2012-2013, 2013-2014 and 2014-2015.

2. Common issues are raised in these appeals, hence, they were heard together and are being disposed of by this consolidate order.

3. For assessment years 2007-2008 to 2009-2010, the assessee has also raised grounds on validity of reopening of assessment, apart from merits. The solitary common issue argued by the learned AR on merits for all the assessment years is whether interest expenditure being amounts paid to the members of assessee-society can be allowed as deduction.

4. The facts pertaining to assessment year 2008-2009 is narrated below. The assessee is a co-operative society formed in the year 1974 by the employees of Vijaya Bank. The main object of the assessee-society is buying of land and developing the same into sites to allot them to its members at a reasonable price. It is a non-profit making organization. For the assessment year 2008-2009, the return of income was filed on 30.09.2008 and the assessment u/s 143(3) was completed on 30.09.2010. Subsequently, the case was reopened by issuance of notice u/s 148 of the I.T.Act.

5. During the course of reassessment proceedings, the Assessing Officer noticed that the assessee had offered interest income of Rs.4,98,19,140 earned on deposits and claimed interest expenditure of Rs.36,385 as interest paid to members on withdrawal of site advance and Rs.4,00,37,240 as interest payment to the members. The assessee was asked to explain the details of the interest expenditure paid to the members amounting to Rs.4,00,37,240. The assessee submitted that the interest expenditure claimed is purely compensatory in nature for delay in allotment of sites to its members. It was further stated that the project of creation of layout at Bangalore-

Mysore Highway was commenced by the assessee in the year 2005. At the time of starting of the project, members were told that the sites shall be handed over to them within 12 months. Since there was delay in implementation of the project, the unutilized funds out of advance collected towards allotment of sites from members were deposited in fixed deposit and such interest earned from deposits was offered to tax. Since there was delay in handing over the sites, the assessee necessarily have to pay a part of the interest earned out of fixed deposit to the members directly as compensation on account of delay. It was further stated that the interest credited to the members would reduce the price payable by the members for the site and thereby the members would have been benefitted. The assessee also submitted that based on the principle of matching concept, the expenditure attributable to the income shall be allowed and taxing the gross receipt without allowing corresponding expenditure incurred thereon is against all principles of canon of taxation. In this context, the assessee had relied on various case laws.

6. The Assessing Officer, however, rejected the objections raised by the assessee. The Assessing Officer brought to tax the gross amount of interest income earned without allowing corresponding interest expenditure incurred / paid to the members. The relevant observation of the Assessing Officer reads as follow:-

- (i) Interest credited is compensatory in nature and there is no relation of cause & effect between interest paid

/ credited to members and interest earned by the assessee.

(ii) The members of the assessee society did not make the advances to earn the interest and assessee-society did not collect the money to earn interest.

(iii) The assessee society was not under any contractual obligation at the time of taking the advance to pay / credit any interest to its members.

(iv) Interest payment to the members by the assessee-society is in the nature of appropriation of income and is not expenditure.

(v) Although source of earning the interest income flows from the advances by members, there is no direct link between members and the interest earned as the members did not contribute the money to earn the interest or for depositing in Fixed Deposits.

(vi) Interest income is non-mutual income and is taxable in the hands of the society based on the following decisions:

- (a) Madras Cricket Club (2011) 334 ITR 238 (Mad.)
- (b) Madras Gymkhana Club (2010) 324 ITR 348 (Mad.)
- (c) Bangalore Club (2013) 350 ITR 509 (SC)

7. The A.O. had made similar additions for the other assessment years, as well.

8. Aggrieved by the additions made by the Assessing Officer for assessment years 2007-2008 to 2009-2010, 2011-2012 to 2014-2015, the assessee preferred appeals to the first appellate authority on legal issue of reopening of assessment as well as on merits. In the course of appellate proceedings, the assessee also filed additional grounds concerning the validity of assessment order passed in the status of a mutual society. On the legal issue the CIT(A) held that the assessee had participated in the assessment proceedings, therefore, the validity of reopening of assessment is to be upheld. As regards the issue on merits, the CIT(A) had listed out the issues for adjudication as under:-

(a) Whether the nature of activity resulting in surplus of the income over expenditure of the society, consisting of its members with the object of “acquiring / development of land for allotment” to its members, could be said to be engaged in the ‘business or profession’, which would be liable to tax?

(b) Whether interest income earned on the surplus of funds collected from members of the society, and kept in FD’s / saving accounts / investments / in Bank / Hundi, would be taxable as income of the society?

(c) If yes, whether expenditure met out from the interest income of such deposits would be deductible from such interest income?

9. As regards the above issues, the CIT(A) concluded as under:-

(a) Assessee is an association of persons for the benefit of members with a mandate to provide developed sites to the members, whose income by way of contribution etc. from members is not taxable on account of mutuality.

(b) Interest income on bank deposits etc. are not related to the object and activities of the association, and hence principle of mutuality is not applicable to such incomes, and the same is liable to be taxed.

(c) Any expenditure for the benefit of members or the assessee-society, met out of such interest income is not deductible from such interest income.

10. Aggrieved by orders passed by the CIT(A), the assessee has filed these appeals before the Tribunal. The learned Counsel for the assessee has filed two sets of paper book for each of the assessment years. In one of the sets of paper book judicial pronouncements relied on by the assessee are enclosed. In the other paper book, copies of the written submissions filed before the CIT(A), audited financial statements, the return of income, the notices issued by the Assessing Officer, etc. are enclosed. The learned AR has also placed on record copy of the resolution authorizing the payment of interest to the members on account of delayed allotment of sites. The learned AR reiterated the submissions made before the Income Tax Authorities.

11. The learned Departmental Representative, on the other hand, supported the orders of the A.O. and the CIT(A).

12. We have heard rival submissions and perused the material on record. To understand the dispute raised, it is necessary to elaborate the facts a little more. As mentioned earlier, the assessee is a housing co-operative society, incorporated in the year 1974 for the purpose of meeting housing needs of the employees of Vijaya Bank. All the members of the society are either present or ex-employees of Vijay Bank. The activities of the assessee-society is to acquire land, convert it into residential sites by developing infrastructure such as roads, streetlights, providing water supply, drainage and allot the same to its members on a no profit no loss basis. The assessee had undertaken a project for creation of layouts at Bangalore-Mysore High Court in the year 2005. At the time of starting of the project, the members of the assessee-society were informed that the site shall be handed over to them within a period of 12 months. As there was delay in implementation of the project, the unutilized funds or idle funds from out of advances collected towards allotment of sites from members were deposited in fixed deposits. The interest earned from the same was offered to tax by the assessee. Therefore, there is no dispute with regard to the taxability of the interest income earned.

12.1 However, since the project was delayed for more than one year, the members expressed anxiety that advances paid by them which are yet to be spent on the project is utilized by the

assessee in making FD's and earning interest. Therefore, the members stated that interest earned should be rightfully belonging to the members. The members unanimously opined that they need to be compensated on account of delay in implementation of project failing which they may be forced to withdraw from the project and demand refund of advance paid to the assessee-society. At that juncture, one of the Directors of Vijay Bank, who is also member of the assessee-society, intervened stating that if members start withdrawing from the project, the same have to be abandoned midway and recovery of payments made so far to the landlord and the developers would become very difficult. Accordingly, he suggested to the members to accept compensation instead of resorting to the withdrawals from the project. It was also stated that the compensation cannot exceed the interest earned from bank on advances received from the members. Accordingly, resolution was passed in the Annual General Meeting of the assessee-society held on 30.09.2007, which reads as follow:-

“Resolved that interest be paid to the members annually, by way of compensation, proportionate on the advance made by them, on the basis of interest earned during each such year.

Further resolved that the interest be credited to a separate account called interest payment to members every year and the same be treated as further contribution of the members of the Society towards the project.

Certified True Copy”

12.2 A copy of certified extract of minutes of AGM of assessee society held on 30.09.2007 for passing the above resolution is on record. Consequent to the above resolution, the assessee-society paid compensation out of interest earned from FD's.

This payment of compensation to members has given rise to the entire dispute in question. Therefore, the only issue is regarding the payment of interest / compensation to the members whether it is allowable deduction to the assessee-society. In view of the above factual background, the order of the A.O. and CIT(A), following issue arises for our adjudication, namely, (i) whether the assessee can be thrust upon a status of a mutual society, (ii) whether the interest expenditure can be allowed as a deduction u/s 37 or u/s 36(1)(iii) of the I.T.Act, and (iii) even assuming that interest income is to be assessed as income from other sources, whether the interest expenditure can be allowed as deduction u/s 57(3) of the I.T.Act.

(i) Whether the assessee can be thrust upon the status of a mutual society:

12.3 It is an undisputed fact that the assessee did not claim any exemption under the concept of mutuality for any of its income. The returns of income have been filed for all the relevant assessment years, like any other commercial undertaking. The Assessing Officer was of the view that the assessee is a mutually benefit society and surplus, if any, from its activities with its members is exempt from tax. Further, the Assessing Officer held that non-mutual income arising from sources other than members is liable to be taxed. Thereby the A.O. held that surplus as reflected in the income and expenditure account is to be ignored and gross income of the interest are liable to taxed. We are of the view that the A.O. cannot on his own decide to grant the benefit of mutuality when it is not claimed by the assessee. The Assessing Officer's cannot

force the assessee to follow a method detrimental to the assessee, more so, when alternative method is not prohibited by law. In the facts of the given case the assessee is not entitled to claim the status of mutual society because there is taint of commerciality in the activities, which we shall discuss in the succeeding paragraphs. The Hon'ble Apex Court in the case of Kumbakonam Mutual Benefit Fund Limited reported in AIR 1965 SC 96, denied the exemption of mutuality because of taint of commerciality by holding as follows:-

“A shareholder in the assessee-company is entitled to participate in the profits without contributing to the funds of the company by taking loans. He is entitled to receive dividend as long as he holds a share. He has not to fulfill any other condition. His position is in no way different from that from a shareholder of a banking company limited by shares. Indeed, the position of the assessee no different from an ordinary bank except that it lends money to and receives deposits from its shareholders. This does not by itself make its income any the less income from business within section 10 of the Indian Income Tax Act.”

12.4 In the instant case, the members even after obtaining site / plot from assessee-society once, is entitled to continue to retain his membership. Therefore, there is no contribution from his side though he is entitled to participate in the profits earned by the assessee-society, which can be distributed in the form of dividend. The very fact that bylaws of the assessee-society contained the provisions that payment of dividend to its members goes to show that it is not a mutual society and commerciality is very much inherent in the activities of the assessee-society. In this regard, clause 75(6) of the Byelaws of the assessee-society is relevant. Therefore, the action of the

Assessing Officer in thrusting the concept of mutuality even when the assessee-society never claimed the concept of mutuality, is bad in law and is hereby set aside.

(ii) Whether the interest expenditure can be allowed as a deduction u/s 37 or u/s 36(1)(iii) of the I.T.Act.

12.5 The interest expenditure claimed by the assessee is purely compensatory to offset cost overrun to the members of the assessee-society. Therefore, based on the principle of matching concept, the expenditure attributable to income ought to be allowed. In this regard reliance is placed on the judgment of the Hon'ble Apex Court in the case of J.K.Industries v. UOI reported on 297 ITR 176 (SC), wherein the Hon'ble Supreme Court had held as follows:-

“The object of incurring expenses is to produce revenue. In measuring the income for a period, revenue is to be adjusted against expenses incurred for producing that revenue. This concept of adjusting / offsetting the expenses against revenue is the matching principle.”

12.6 The above proposition further draws strength from the judgment of the Hon'ble Apex Court in the case of CIT v. Lakshmi Machine Works reported in 290 ITR 667 (SC), wherein the Hon'ble Supreme Court had held as follows:-

“The tax under the Act is upon income, profits and gains. It is not a tax on gross receipts. Under section 2(24) the word 'income' includes profits and gains. The charge is not on gross receipts but on profits and gains properly so-called. Gross receipts or sale proceeds, however, include profits. However, subject to special requirements of the income tax, profits have got to be assessed provided they are real profits. Such profits have to be got to be ascertained on ordinary principles of commercial trading and accounting. However, the income-tax has laid down certain rules to be applied in deciding how the

tax should be assessed and even if the result is to tax as profits what cannot be construed as profits, still the requirements of the income-tax must be complied with. Where a deduction is necessary in order to ascertain the profits and gains, such deductions should be allowed. Profits should be computed after deducting the expenses incurred for business though such expenses may not be admissible expressly under the Act, unless such expenses are expressly disallowed by the Act.”

12.7 Further, the Income Tax Authorities failed to appreciate that the money contributed by the members was invested in FD's and the portion of the interest earned thereon was credited to the account of the members way of compensation for delay in allotment of sites to the members. Therefore, the interest paid on advances from members is chargeable on interest income earned from depositing the same with the bank by the assessee. In other words, there is a direct nexus between the contribution by the members, which was utilized for making fixed deposit to earn interest income and payment of portion of such interest income earned as compensation to members for delayed allotment of sites. Therefore, the interest credited to the members is wholly and exclusively for the purpose of business and entitled to deduction u/s 37(1) of the I.T.Act. For claiming expenditure u/s 37(1) of the I.T.Act, there was no need for a cause and effect relationship between an item of income and expenditure as claimed by the A.O. All that would be necessary is only that it is for the “purpose of business” and not necessary for earning of the income. In this context, reliance is placed on the judgment of the Hon'ble Apex Court in the case of *Sassoon J David & Co. Pvt. Ltd. v. CIT* reported in 118 ITR 261.

Even assuming that interest income is assessed as income from other sources, whether the interest expenditure ought to be allowed as a deduction u/s 57(iii) of the I.T.Act.

12.8 As mentioned earlier, the interest paid on advances from members is chargeable on interest income earned from depositing the same with banks by the assessee because had there been no advances from members, there would not have arisen the interest income to the assessee-society. This being the situation, it necessarily follows that the interest paid / credited to the members on account of the advances is an expenditure laid out or expended wholly and exclusively for the earning of the interest income. The Hon'ble Delhi High Court in the case of CIT v. Sasan Power Limited reported in 18 taxmann.com 182 (Delhi) had held that when interest income and interest expenditure are inextricably linked and there was commonality in nature and purpose, the expenditure is allowable as deduction u/s 57(iii) of the I.T.Act. In the case of Taj International Jewellers reported in 335 ITR 144, the Hon'ble Delhi High Court had held that when there is no dispute that money obtained on loan was converted and made into fixed deposit receipts, the interest on loan was an allowable deduction against the interest income earned from fixed deposit.

12.9 The Assessing Officer has taken a view that there is no obligation on the assessee-society to pay interest to its members when advance was received. Therefore, the A.O. concluded that there is no contractual obligation to pay interest. On the other hand, we are of the view that it is not the

requirement under Contract Law that all terms of the contract be agreed upon upfront and there is no scope for alteration thereafter. In the instant case, the delay in procuring the land and formation of site was unforeseen at the initial stage when advances were collected by the assessee-society. Having parted with money and also with site allotment being delayed, the expectation of the members to be compensated by way of interest on their advances is only legitimate. In view of the foregoing reasoning, we are of the view that even assuming that interest income is to be taxed under the head "income from other sources", the interest expenditure that is paid to the members of the assessee-society is to be allowed u/s 57(iii) of the I.T.Act. It is ordered accordingly.

12.10 Therefore, the grounds raised on the merits are allowed.

12.11 As regards the issue raised with regard to the validity of assessment, the AR did not make any argument during the course of hearing. Therefore, the grounds regarding validity of reopening of assessment are not adjudicated.

13. In the result, the appeals filed by the assessee are partly allowed, as indicated above.

Order pronounced on this 1st day of April, 2021.

Sd/-
(B.R.Baskaran)
ACCOUNTANT MEMBER

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 01st April, 2021.
Devadas G*

Copy to :

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2. The Respondent.
3. The CIT(A)-4, Bangalore.
4. The Pr.CIT-4, Bangalore.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore