

**IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE “SMC-B” BENCH, BANGALORE**

Before Shri George George K, Judicial Member

ITA No.207/Bang/2020 : Asst.Year 2016-2017

M/s.Panaje Cabank Limited Panaje Post, Puttur Taluk Arlapadavu, Puttur – 574 259, DK District. PAN : AAALP0109R.	v.	The Income Tax Officer Ward 1 Puttur.
(Appellant)		(Respondent)

Appellant by : Sri.Narendra Sharma, Advocate
Respondent by : Sri.Ganesh R.Ghale, Standing Counsel

Date of Hearing : 08.10.2021	Date of Pronouncement : 11.10.2021
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ORDER

This appeal at the instance of the assessee is directed against CIT(A)'s order dated 06.01.2020. The relevant assessment year is 2016-2017.

2. The grounds raised read as follows:-

“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.8OP[2][a][i] of the Act amounting to Rs.32,32,522/- 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 and associate

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 judgment 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 co-operative society had no doubt admitted nominal and associate members, which was permissible under the Karnataka Co-operatives Societies Act, 1959 but, 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 upheld the assessment of income earned by the appellant from investments made in South Canara District Co-op. Bank to the extent of Rs. 34,72,751/- under the head "Other Sources" as against the claim of the appellant that the said interest income formed part of the income from business of providing credit facilities to the members and thus, was entitled to deduction u/s. 80P [2][a][i] of the Act following the judgement of the Hon'ble Karnataka High Court in the case of TUMKUR MERCHANTS SOUHARDA CREDIT CO-OPERATIVE LTD reported in [2015] 230 Taxman 309 [Kar] 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 to its members and not under the head 'Other Sources' under the facts and in the 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 by allowing the actual interest paid on member's deposits while assessing the interest income under the head "Other Sources" instead of the arbitrary allowance of 10% of the income as incidental expenses, 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 234B 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."

3. The brief facts of the case are as follows:

The assessee is a primary agricultural credit society registered under the Karnataka Co-operative Societies Act, 1959. It is engaged in the business of providing credit facilities to its members. For the assessment year 2016-2017, the return of income was filed on 13.10.2016 declaring total income of Rs.97,720, after claiming deduction of Rs.31,32,522 u/s 80P(2) of the I.T.Act. The assessment was selected for scrutiny. The Assessing Officer disallowed the claim of deduction u/s 80P(2) of the I.T.Act. The Assessing Officer held that the assessee has violated the principles of mutuality by placing reliance on the judgment of the Hon'ble Apex Court in the case of *The Citizen Co-operative Society Ltd. v. ACIT reported in 397 ITR 1 (SC)*. The Assessing Officer also

denied the claim of deduction u/s 80P(2)(d) of the I.T.Act since interest / dividend income was earned out of investments with co-operative banks. For denying the claim of deduction u/s 80P(2)(d) of the I.T.Act, the Assessing Officer relied on the judgment of the Hon'ble Karnataka High Court in the case of *Totagars Co-operative Sales Society reported in 395 ITR 611 (Kar.)*.

4. Aggrieved by the disallowance of deduction u/s 80P of the I.T.Act, the assessee preferred an appeal to the first appellate authority. The CIT(A) confirmed the view taken by the Assessing Officer. The CIT(A) held that the assessee was having more than 15% members as associate / nominal members, which violates the provisions of Karnataka Co-operative Societies Act, 1959. The CIT(A) further held that since the assessee was having majority of dealing with non-members, the judgment of the Hon'ble Apex Court in the case of *The Citizen Co-operative Society Ltd. v. ACIT (supra)*, is clearly applicable. The CIT(A) concluded by stating that as per the judgment of the Hon'ble Apex Court in the case of *The Citizen Co-operative Society Ltd. v. ACIT (supra)*, once the principle of mutuality is violated, deduction u/s 80P(2)(d) of the I.T.Act is also not to be allowed.

5. Aggrieved, the assessee has filed this appeal before the Tribunal. The learned AR submitted that on identical issue, the Bangalore Bench of the Tribunal in the case of *M/s.Ravindra Multipurpose Co-operative Society Ltd. v. ITO* in ITA No.1262/Bang/2019 (order dated 31.08.2021) by

following the judgment of the Hon'ble Apex Court in the case of *M/s.Mavilayi Service Co-operative Bank Ltd. v. CIT* reported in 431 ITR 1 (SC) restored the claim of deduction u/s 80P(2)(of the I.T.Act to the files of the A.O. for fresh consideration.

6. The learned Standing Counsel strongly supported the orders of the Income Tax Authorities.

7. I have heard rival submissions and perused the material on record. The Division Bench of the Tribunal in the case of *M/s.Ravindra Multipurpose Co-operative Society Limited v. ITO (supra)* had remanded the identical issue to the files of the A.O. for *de novo* consideration. The Tribunal directed the A.O. to follow the dictum laid down by the Hon'ble Apex Court in the case of *M/s.Mavilayi Service Co-operative Bank Ltd. v. CIT (supra)*. The relevant finding of the ITAT in the case of *M/s.Ravindra Multipurpose Co-operative Society Ltd. v. ITO (supra)* reads as follow:-

“6. Grounds 2-4 & additional Ground No.1:

In respect of associate / nominal members, Hon'ble Supreme Court in the case of Mavilay Service Co-operative Bank Ltd. v. CIT (2021) 123 taxmann.com 161 (SC) has held that the expression “Members” is not defined in the Income-tax Act. Hence, it is necessary to construe the expression “Members” in section 80P(2)(a)(i) of the Act in the light of definition of that expression as contained in the concerned co-operative societies Act. In view of this, the facts are to be examined in the light of principles laid down by the Hon'ble Supreme Court in Mavilayi Service Cooperative Bank Ltd. (surpa). Accordingly, we remit this issue of deduction u/s 80P(2)(a)(i) of the Act to the files of Ld.AO to examine the same de novo in the light of the above judgment. Needless to say that proper opportunity of being heard is to be granted to assess in accordance with law.”

7.1 In view of the order of the ITAT, which is identical to the facts of the instant case, I restore the issue of claim of deduction u/s 80P of the I.T.Act to the files of the A.O. for *de novo* consideration.

7.2 As regards the claim of deduction u/s 80P(2)(d) of the I.T.Act, the CIT(A) has not adjudicated the same for the reason that the assessee has violated the principle of mutuality. If the assessee receives / earns interest / dividend income out of investments with co-operative society, the same is entitled to deduction u/s 80P(2)(d) of the I.T.Act. With these observations, we direct the A.O. to examine the claim of deduction u/s 80P(2)(d) of the I.T.Act, afresh.

7.3 Insofar as ground No.8 is concerned, I find an identical issue was considered by the Hon'ble jurisdictional High Court in the case of Totgars Co-operative Sales Society Ltd. v. ITO reported in [2015] 58 Taxmann.com 35 (Karnataka) (judgment dated 25.03.2015). The relevant findings of the Hon'ble High Court, read as follows:-

“11. Having heard the learned counsel for the parties and perusing the records and in the light of the finding recorded by the Hon'ble Supreme Court that the interest income earned by the appellant falls within the category of “other income” what falls for consideration is to answer the question as to whether the Tribunal was right in law in holding that the income by way of interest was chargeable to tax under Section 56 of the Income Tax Act without allowing deduction in respect of proportionate costs incurred as permissible under Section 57.

12. It is no doubt true that the appellant did initially claim deduction under Section 80P(2). Upon the pronouncement of the order by the Apex Court, in these appeals referred to supra, the income earned on the interest is declared as “other income” falling under Section 56 of the Income Tax Act. Then

the next immediate question that follows is as to whether the entire fund i.e., in deposit with the Bank is taxable or the proportionate expenditure incurred by the appellant requires deduction. It is logical that when the Revenue is permitted to assess and recover taxes from assessee under Section 56 by treating the income earned by interest as income from "other sources", the appellant shall be entitled for proportionate expenditure cost incurred in mobilizing the deposit placed in the Bank/s. What can be taxed is only the net income which the appellant earns after deducting cost and expenditure incurred and administrative expenses incurred by the assessee.

13. Accordingly, we answer the question of law and hold that the Tribunal was not right in coming to the conclusion that the interest earned by the appellant is an income from other sources without allowing deduction in respect of the proportionate costs, administrative expenses incurred in respect of such deposits."

7.4 The assessee has not raised the plea before the Income Tax Authorities that it has to be given deduction u/s 57 of the I.T.Act, in respect of expenditure for earning the interest income. However, inspite of such plea not being raised before the lower authorities, I am of the view that since the fundamental principle under Income-tax Act being that only net income has to be taxed and not the gross income, this plea of the assessee has to be necessarily entertained, especially in the light of the judgment of the Hon'ble jurisdictional High Court in the case of Totgars Sales Co-operative Society Limited v. ITO [2015] 58 taxmann.com 35 (Karnataka). Accordingly, the issue of deduction u/s 57 of the I.T.Act is restored to the files of the A.O. The A.O. is directed to examine whether assessee has incurred any expenditure for earning interest income, which is assessed under the head 'income from other sources'. If so, the same shall be allowed as deduction u/s 57 of the I.T.Act. The assessee is directed to

co-operate with the department and furnish the necessary evidence for expeditious disposal of the matter. It is ordered accordingly.

8. In the result, the appeal filed by the assessee is allowed for statistical purposes.

Order pronounced on this 11th day of October, 2021.

Sd/-
(George George K)
JUDICIAL MEMBER

Bangalore; Dated : 11th October, 2021.
Devadas G*

Copy to :

1. The Appellant.
2. The Respondent.
3. The CIT(A), Mangaluru.
4. The Pr.CIT, Mangaluru.
5. The DR, ITAT, Bengaluru.
6. Guard File.

Asst.Registrar/ITAT, Bangalore