

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

Before Shri Sanjay Arora, AM & Shri Aby T. Varkey, JM

ITA No.922/Coch/2022: Asst. Year:2017-2018

Aryanad Service Co-operative Bank Limited, No.593, Bank Building, Aryanand Trivandrum – 695 542. [PAN: AAAAAA9512F]	vs.	The Income Tax Officer Ward 2(3), Trivandrum.
(Appellant)		(Respondent)

Appellant by: Sri.Arun Raj S, Advocate
Respondent by: Smt.J.M.Jamuna Devi, Sr. DR

Date of Hearing : 17.05.2023	Date of Pronouncement: 31.07.2023
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ORDER

Per Sanjay Arora, AM:

This is an Appeal by the Assessee directed against the order dated 12/8/2022 by the Commissioner of Income Tax (Appeals), National Faceless Appeal Centre, Delhi ('CIT(A)' for short), dismissing the assessee's appeal contesting its assessment under section 143(3) of the Income Tax Act, 1961 ('the Act' hereinafter) dated 11/12/2019 for assessment year (AY)2017-18.

2.1 We begin by recounting the background facts of the case. The assessee, a co-operative society, registered as a Primary Agricultural Credit Society (PACS) under the Kerala Co-operative Societies Act, 1969 ('Kerala Act') on 25.12.1923 for servicing the area of Aryanad Panchayath of Trivandrum District, filed its return of income for the relevant year belatedly, on 31.3.2018, disclosing nil income, even as its audited profit and loss account reflected a net profit of Rs.1,17,247. The same was selected for being subject to the verification procedure under the Act in view of huge cash deposits with other banks during demonetization period (09.11.2016 to

31.12.2016), i.e., at Rs.98.87 lakhs and Rs.74.48 lakhs with Trivandrum District Co-operative Bank and Kerala Gramin Bank respectively. The Assessing Officer (AO), in assessment proceedings, observed the following:

- (a) The assessee was, apart from advancing agricultural loans, also giving loans for other purposes as well;
- (b) The assessee accepts deposits from persons for the purpose of making deposits therewith, or availing loan therefrom, by requiring them to become a Member by filling up a membership application form;
- (c) The assessee is also running various chit funds, which is again in the nature of banking; and
- (d) It had transferred a major portion of its profits to certain special reserves u/s.36(1)(viii), applicable to a co-operative bank, i.e., other than a PACS or a Primary Co-operative Agricultural and Rural Development Bank (PCARDB).

The assessee was, thus, in his view, engaged in the business of banking, i.e., a co-operative bank, without though obtaining a license from the Reserve Bank of India (RBI). That apart, interest income of Rs.84.08 lacs earned by it on deposits with other banks/financial institutions, being on its surplus funds, not required for the time being, were liable to be assessed u/s. 56, i.e., as income from other sources. The amount transferred to and from special reserves, by way of debit and credit respectively to the profit and loss a/c, were excluded by him to yield a net profit of Rs.64,65,231, which was accordingly assessed u/s.56 and u/s.28 at Rs.84,07,706 and (-) Rs.19,42,475 respectively. Reliance for the purpose was placed by him on *Pr.CIT v. Poonjar Service Co-op. Bank Ltd.* [2019] 414 ITR 67 (Ker)(FB).

2.2 In appeal, the assessee clarified that carrying on the business of banking was only incidental to its primary object of extending loans to agriculturists of the AryanadPanchayath. The sums invested with other co-operative banks is only in terms of the directions by the Department of Co-operative Societies, Government of Kerala, issued under the Kerala Act. The interest income earned is, thus, also liable to be regarded as from business inasmuch as it is incidental to the business of

banking and providing credit facilities to it's members. The decision in *Totgar's Co-operative Sale Society Ltd. v. ITO* [2010] 322 ITR 283 (SC), shall not apply in the facts of the case, which stand distinguished by the Hon'ble Karnataka High Court in *Tumkur Merchants Souharda Credit Co-operative Ltd.* (in ITA No.307 of 2014), reported at [2015] 230 Taxman 309 (Kar). The Id.CIT(A), on a factual and legal analysis, came to the conclusion that the assessee is a co-operative bank, i.e., a co-operative society in the business of banking, *albeit* without a license from RBI. The interest income could be considered as 'business income' *only* if the assessee was providing credit facilities only to it's members for agricultural and allied purposes, which is not the case. The restriction of sec.80P(4) would thus apply, excluding the benefit of sec.80P to the assessee. Aggrieved, the assessee is in second appeal.

3. Before us, it was submitted by Sri.Raj, the Id. counsel for the assessee, that even assuming that the interest income is assessable as income from other sources, it is exempt u/s.80P(2)(d), providing deduction in respect of interest or dividend income derived by a co-operative society on its investment with another co-operative society. The Hon'ble jurisdictional High Court has in *Pr.CIT v. Peroorkada SCB Ltd.* [2022] 442 ITR 141 (Ker), placing a copy of the same on record, clarified that the investment in a co-operative bank would be exigible for deduction u/s.80P(2)(d) inasmuch as the co-operative bank is also a co-operative society, *albeit* in the business of banking. Smt.Jamuna Devi, the Id.Sr.DR, would, in response, rely on the orders by the Revenue authorities.

4. We have heard the parties, and perused the material on record.

4.1 The first issue before us is if the assessee is an eligible entity u/s.80P of the Act inasmuch as sec.80P(4) excludes, w.e.f. 01.04.2007 (i.e., AY 2007-2008 onwards), a co-operative bank, other than excepted categories, being PACS and PCARDB, from the purview of sec.80P. The Hon'ble Apex Court in *Mavilayi Service Co-operative Bank Ltd. v. CIT* [2021] 431 ITR 1 (SC), reversing the decision

by the Hon'ble jurisdictional High Court in *Poonjar SCB Ltd.* (supra), clarified that whether a co-operative society is a PACS (or PCARDB) is irrelevant for the purpose of deduction u/s.80P where it is not a co-operative bank, i.e., a co-operative society in the business of banking, as defined u/s.5(b) of the Banking Regulations Act, 1949 (BRA), which in fact is not applicable to a PACS (sec.3 of BRA). Such societies shall, therefore, be entitled to deduction u/s.80P(2)(a)(i) to the extent of income attributable to the activities specified therein, i.e., banking or the provision of credit facilities to its members. Further, as the Kerala Act draws no distinction between 'real' and 'nominal' members, i.e., for the purpose of accepting deposits from, or extending loans thereto, the same could not be by the assessing authority under the Act. All the four categories of members, i.e., A, B, C and D, recognized under the Kerala Act, would, irrespective of some category of Members having no voting rights or being not entitled to participate in the surplus, stand to fall within the scope of the term 'member' as envisaged in sec.80P(2).

In the facts of the instant case, the Revenue regards the assessee-society as being engaged in the business of banking and, thus, a co-operative bank by definition, *albeit* without a license from RBI. Sec.5(b) of the BRA, defines banking business, as under:

5. Interpretation.—In this Act, unless there is anything repugnant in the subject or context,—

- (a) "approved securities" means
- (b) "banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft, order or otherwise;

The members of the assessee-society can deposit their monies with it, as well as obtain loans from it. Monies held in deposit accounts are liable to be, in terms and conditions thereof, as is the case with regular banks, liable to be withdrawn. Further, there is no specific qualification to become a member, and any person who can open a bank account can become a member by making an application in this regard. A 'nominal' member, i.e., category C or D member, has no voting rights or

participation rights in the profits, so that they are not members in the real sense. *This explains the Revenue's stand.* We further observe that the restriction regarding the area of operation by the first *proviso* to sec.2(oa) of the Kerala Act, as AryanadPanchayath, District Trivandrum, in the instant case, is not applicable to societies or banks in existence at the commencement of the Kerala Co-operative Societies (Amendment) Act, 1999, as the assessee. The assessee-society is thus entitled to service any member of the public at large, giving it the character of a public entity, at par with a cooperative bank. The second *proviso* to sec.2(oa) (renumbered as s. 2(oaa) by the Kerala Cooperative (Amendment) Act, 2013), as substituted by the Amendment Act of 1999, clearly provides that in the event of the principal object/s being not fulfilled, the PACS shall lose all its characteristics of being one such, except for staff strength.

The same, however, did not find favour with the Hon'ble Apex Court in *Mavilayi SCB Ltd.* (supra), since followed in *Pr. CIT v. Annasaheb Patil Mathadi Ltd.* [2023] 454 ITR 117 (SC), inasmuch as a category C or D member is only in terms of the Kerala Act. Section 2(l) defines a 'member' as inclusive of a nominal or associate member, separately defined u/s. 2(m) to mean a member who possesses only such privileges and rights, and is subject to such liabilities, as specified in the bye-laws. There was thus no parallel with the Andhra Pradesh Mutually Aided Co-operative Societies Act, 1995, which had no provision for such members, so that the appellant-society in *The Citizen Co-operative Society Ltd. v. Asst. CIT* [2017] 397 ITR 1 (SC) was acting illegally, even as held by the Hon'ble Apex Court in that case. A society as the assessee, in accepting deposit from a nominal member, or extending loan thereto, thus, does not act illegally, but only *intra vires* the Kerala Act.

The assessee-society is, accordingly, an eligible entity u/s.80P, notwithstanding that it may not be a PACS in terms of s. 2(oaa) of the Kerala Act, or indeed sec. 5(cciv) of the BRA.

4.2 The next question that arises is the head of income under which its income of Rs.64,65,231 for the year is to be split, i.e., between the business income (s.28) and income from other sources (s.56). We see this as a non-issue. The reason is simple. There has clearly been, on account of demonetization, a spurt in the cash deposits with the assessee, which, in turn, stand deposited by it with the two co-operative banks with which it maintains account. It is facile to accept, as the assessee claims, that the same is so deposited as a part of its business of providing credit to its members. There is nothing to show, not even a contention to the effect that the volume of its business, i.e., the demand for funds from its customer-members, also stood simultaneously increased. Rather, where so, it would have led to a corresponding increase in the interest from members, and not on bank deposits. This, however, would matter little as the bank interest, even if assessable u/s.56, would stand to be deductible u/s.80P(2)(d), as held in *Peroorkada SCB Ltd.*(supra), on which the assessee relies before us. In our humble view though, sec.80P(4) makes sec.80P inapplicable to co-operative banks, i.e., other than the two excepted categories (of PACS or PCARDB), and sec.80P(d) clearly provides exemption only where both the *lender (depositor)* and the *borrower (depositee)* is a co-operative society. This is as in that case income is derived from an eligible source, with the funds continuing to remain in a closed circuit, as explained in *Bangalore Club v. CIT*[2013] 350 ITR 509 (SC). A co-operative bank, on the other hand, is a public entity, and the money deposited with it on being further advanced to its customers, goes in the public domain, rupturing this circuit. A cooperative society, it may be noted, is, as indeed in the instant case, assessable as an 'Association of Persons'. It may here also be emphasized that s. 80-P(2)(d) is applicable to any set of two cooperative societies, i.e., other than the excluded category of cooperative banks (s. 80-P(4)), and irrespective of the nature of their business/activity and, further, irrespective of whether their income falls to be deductible under any of the other clauses of s. 80P. Be that as it may, in view of the decision in *Peroorkada SCB*

Ltd.(supra), binding on us, the head of income under which the interest income, being deductible u/s.80P(2)(a)(i) and/or sec.80P(2)(d), is assessable, is rendered of no consequence. In fact, the gross interest of Rs.84.08 lakhs cannot be assessed as income inasmuch as deduction/s u/s.57 would have to be necessarily allowed in computing the same, and which exercise may, again, not be of any consequence. We may at this stage also advert to *Totgar's Co-operative Sale Society Ltd.* (supra) with a view to state its ratio, applicability of which would, in a given case, determine if the interest income is an operational income or arises *qua* surplus funds, assessable u/s. 56. And, that is, interest on surplus funds, i.e., not required for the time being for its operational activities, and which is largely and essentially a question of fact, would stand to be assessed as income from other sources, as opposed to operational income, which may, where specified, be exempt u/s. 80-P. Continuing further, being in the nature of a passive income, is predominantly liable to be assessed u/s. 56, though the same, i.e., the head of income under which interest or dividend income is assessable, is by itself of little consequence or irrelevant for the purposes of s. 80-P(2)(d).

4.3 Finally, we may consider the import of the factual observation, not rebutted at any stage, of the assessee undertaking chit fund scheme/s, and which is in the nature of banking. The same, in our view, is only a manner of providing credit facilities to its members. The foreman commission earned by the assessee in the bargain would be the income of such business. Accordingly, nothing, in our view, turns on the assessee running a chit fund scheme/s. This in fact we find to be the clear stand of the Hon'ble jurisdictional High Court in *CIT v. Kottayam Coop. Bank* [1974] 96 ITR 181 (Ker), even otherwise binding on us. We are conscious that running of nidhi, chit-fund, etc. schemes, is a regulated business, requiring RBI approval, which is normally sought by and granted to non-banking financial companies, an aspect on which the decision in *Kottayam Coop. Bank* (supra) is *sub silentio*. The assessee, a PACS, to which BRA is not applicable, the question of it being registered with, or

having sought RBI approval, does not arise. That, to our mind, would not detract from the assessee's income, to the extent it so qualifies, being exempt under the Act. Any violation of any law, even if inadvertently, would not by itself impinge adversely on the status of such income under the Act, i.e., tax-exempt or otherwise.

5. We, accordingly, hold the following incomes arising to the appellant-society as deductible u/s. 80P(1):

(a) income attributable to the appellant-society from the activity specified in s. 80P(2)(a)(i), i.e., of providing credit to its members, real or nominal, i.e., *other than from non-members*;

(b) interest income, net of expenditure attributable thereto, on deposits with a co-operative society or cooperative bank, shall, where and to the extent, not falling within the activity specified u/s.80P(2)(a)(i), is deductible w.r.t. s.80P(2)(d);

(We are conscious of an overlap between (a) and (b) *qua* the interest income on deposits with co-operative societies/banks. However, in either case, i.e., it falling u/s.80P(2)(a)(i) or sec.80P(2)(d), is deductible in full. No useful purpose to our mind would therefore be served by determining the extent to which it falls under either, including may be nil under one of them. The same, thus, can be segregated from the total income of Rs.64.65 lakhs, as being exempt u/s.80P(1) r/w either sub-clause of sec.80P(2). As a corollary, the head of income under which it is assessable, i.e., as business income (s.28) or income from other sources (s.56), becomes irrelevant.)

(c) any income, not falling under the clause (a) and (b), shall be exempt to the extent of Rs.50,000 w.r.t. sec.80P(2)(c)(ii).

6. We consider it pertinent to, before parting with our order, state an observation in the matter. Income-tax Act is a Central Act, applicable uniformly across India. Cooperative sector, which has made deep made inroads into the rural economy of the country, is, with a view to encourage it, extended a beneficial treatment under the Act, noted time and again by the Hon'ble Apex Court, as recently in *Mavilayi SCB Ltd.*(supra). Banks are public entities, so that, save where operating with the primary object of serving the agriculture sector, as PACS (to which BRA does not apply), or PCARDB (which is again principally for providing long-term credit for agriculture and rural development), co-operative banks stand excluded from the purview of

sec.80P w.e.f. 01.04.2007. A co-operative society is defined u/s.2(19) of the Act as one registered under the Co-operative Societies Act, 1912, or under any other law for the time being in force in any State (of India) for registration of co-operative societies. State Co-operative Societies Acts differ not only in the procedural aspects, but also in the fundamental aspect of who constitutes a Member of one such. Inasmuch as it exists and functions for the benefit of it's members, a co-operative society is assessable under the Act as an AOP, and which, coupled with it being a vehicle for providing impetus to the agricultural sector of the economy, furnishes the rationale for the exemption of it's income under the Act. There is no uniformity as to who could be a member of a cooperative society, i.e., in terms of its defining attributes, across different State Cooperative Societies Acts. Any member of the public could, for instance, become its member on paying, say, a nominal fee, and even as the same carries no voting rights or participating rights in the profits. That is to say, membership with differential rights. While valid in law, as indeed is the membership (shareholding) with differential rights in a company, it removes the uniform basis for application of the Central Act. This becomes particularly relevant as the transactions of the society with it's members are accorded a beneficial treatment under the Act. Accordingly, transaction valid in one State may not be so and, thus, not legal in another, or in the least liable to be regarded as a transaction with a non-member, in another. This aspect, which has recently come to the fore per the decision in *Mavilayi SCB Ltd.*(supra), explaining it's decision by the Hon'ble Apex Court in *The Citizen Co-operative Society Ltd.* (supra), rendered w.r.t. a different State Cooperative Act, is an area which, to our mind, requires consideration by the law makers of the country, toward, as afore-stated, a uniform application of the Act across the country.

7. In the result, the assessee's appeal is allowed on the foregoing terms.

Order pronounced on July 31, 2023 under Rule 34 of The Income Tax (Appellate Tribunal) Rules, 1963

Sd/-
(AbyT.Varkey)
Judicial Member

Sd/-
(Sanjay Arora)
Accountant Member

Cochin; Dated: July 31, 2023
Devadas G*

Copy to:

1. The Appellant.
2. The Respondent.
3. The CIT(Appeals), Trivandrum.
4. The Pr. CIT concerned.
5. The Sr. DR, ITAT, Cochin.
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Asst.Registrar
ITAT, Cochin