

**IN THE INCOME TAX APPELLATE TRIBUNAL
“B” BENCH: BANGALORE**

**BEFORE SHRI GEORGE GEORGE K., VICE PRESIDENT
AND
SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER**

ITA No.235/Bang/2024
Assessment Year: 2017-18

Katapady Co-op. Agricultural Society Ltd. Katapady Kaup Taluk Udupi Dist 574 105 Karnataka PAN NO.AAAAK1762G	Vs.	ITO Ward-2 Udupi
ASSESSEE		RESPONDENT

Assessee by	:	Shri Mahesh R Uppin, A.R.
Revenue by	:	Shri Ganesh R. Ghale, Standing Counsel for Revenue.

Date of Hearing	:	10.04.2024
Date of Pronouncement	:	10.04.2024

O R D E R

PER CHANDRA POOJARI, ACCOUNTANT MEMBER:

This appeal by assessee is directed against order of NFAC for the assessment year 2017-18 dated 11.12.2023 passed u/s 250 of the Income Tax Act, 1961 (in short “The Act”). The assessee has raised following grounds of appeal:

1. *Whether on the facts and circumstances of the case, the below authorities were justified in holding that the 'concept of mutuality' was missing in appellant society.*

2. *Whether both the below authorities were right in denying the benefit of deduction u/s. 80P of the Act in respect of Interest on Investments derived by the appellant from SCDC Bank to the extent deduction claimed in the ITR amounting to Rs. 23,43,881/- (as against the interest earned of Rs. 32,71,113/-).*

3. *Whether or not the interest on investments from Co-operative Banks that accrued to the appellant from its mandatory maintenance of fluid resources as required under its governing statute qualify for deduction u/s. 8P(2)(d) of the Act.*

4. *Does the action of CIT (A) not run contrary to CBDT Circular No. 37/2016 dated 02-11-2016 in denying the relief to the extent of disallowance made due to addition of differential provision for Interest payable on Deposits of Rs. 9,98,785/- to the returned income of the appellant in the impugned order.*

5. *The impugned orders passed by both the below authorities are in violation of established principles laid down by Hon Apex Court and jurisdictional High Court.*

2. Facts of the issue are that the assessee is a Primary Agricultural Credit Society registered under the provisions of Karnataka Co-operative Societies Act, 1959. The Assessee is in the business of providing credit facilities to its members for their agriculture related activities, selling of fertilizers, manure and PDS distribution and other allied activities as permitted under its By-laws duly approved by the Registrar of Co-operative Societies. The assessee is carrying on its business well within the frame work of law and exclusively with its members and it is not doing any business with non-members. The assessee had filed its Return of income declaring a GTI of Rs.23,64,397/- and claiming deduction of Rs.23,43,881/- u/s 80P(2)(a)(i) of the Act. In the assessment proceedings, the declared Business Income of the Assessee (Which was inclusive of Interest on Investments) was held to be ineligible for deduction u/s 80P of the Act on the ground that the assessee had transacted with nominal and associate members and that its interest income was chargeable under Sec.56 of the Act under Income from other sources. Further, the A.O. has also disallowed the Interest Payable provision of Rs.9,98,785/- on the ground that the assessee was following hybrid system of accounting. Thus, the GTI of the assessee came to be determined at Rs.33,63,182/- against which no deduction was given under Sec 80P and the entire Total Income of

Rs.33,63, 182/- was brought under tax levying tax plus interest of Rs.13,74,796/-.

2.1 Ground Nos.2 & 3 are with regard to denial of deduction u/s 80P(2)(a)(i) of the Act. The ld. CIT(A) observed that these grounds are directed against the AO's action of rejecting the assessee's claim for deduction of interest income of Rs.32,71,113/- u/s 80P(2)(a)(i) of the Act after having held to be income from other sources and not income from the activity of business of banking or providing credit facilities to the members of the assessee society as mandated u/s 80P(2)(a)(i) of the Act. He observed that the assessee has, through its statement of facts and written submissions contended that the interest of Rs.32,71,113/- was not only earned from parking its surplus funds with the banks, rather a part of it represents interest earned on the statutory reserve fund which is mandatory under the Karnataka Co-operative Societies Act. The entire interest on investments is part of its business. In such backdrop, the assessee has submitted that all such interest should be treated as business income and eligible for deduction u/s 80P(2)(a)(i) of the Act before ld. CIT(A).

2.2 Apropos the above ground, the ld. CIT(A) after going through the facts of the case and submissions of the assessee and the order of assessment passed by the AO denying the assessee's claim for deduction of Rs.32,71,113/- u/s 80P(2)(a)(i) of the Act observed that, the impugned interest has been earned from parking its funds with the Scheduled Banks and the Co-operative Banks. Ostensibly, the banks are not the members of the assessee society. Evidently the assessee has not been carrying on the banking business with the public or other concerns, not being its members and such banking business cannot be undertaken by the assessee society as it has not obtained any license from the RBI to carry on such banking. The parking of funds with banks cannot also be equated with the activity of providing credit facilities to the members. There are a plethora of judicial pronouncements holding that the interest income earned

from the deposits with the banks of funds 'not immediately required to be lent to the members' is to be assessed as income from other sources u/s 56 of the Act and not as business income u/s 28 of the Act. This view is fortified by the judgments of the Hon'ble High Court of Gujarat in State Bank of India vs. CIT (72 taxmann.com 64), the Hon'ble jurisdictional High Court of Karnataka in PCIT vs. Totagar Co-operative Sale Society (83 taxmann.com 140), the Hon'ble High Court of Punjab and Haryana in CIT vs. Punjab State Co-op Agricultural Development Bank Ltd. (76 taxmann.com 307) and the Hon'ble Calcutta High Court in CIT vs. South Eastern Railway Employees' Co-op Credit Society (73 taxmann.com 123). The Id. CIT(A) observed that in all these judgments, the Hon'ble Courts have consistently held that interest income earned by the co-operative society from its investment made with the co-operative banks or other nationalized banks or the treasury is assessable as income from other sources u/s 56 of the Act and the same would not be eligible for deduction u/s 80P(2)(a)(i) of the Act.

2.3 The Id. CIT(A) further observed that this amount of Rs.32,71,113/- earned by assessee from its investment with the Scheduled banks/Co-operative banks is not attributable to the business of providing credit facility to its members as envisaged u/s 80P(2)(a)(i) of the Act. Against this assessee is in appeal before us.

3. We have heard the rival submissions and perused the materials available on record. Similar issue came for consideration before this Tribunal in the case of Vittal Grameena Scheduled Bank Niyamitha in ITA No.895/Bang/2023 dated 6.2.2024, wherein held as under:

“6. *We have heard the rival submissions and perused the materials available on record. The Hon'ble Apex Court in the case of Mavilayi Service Co-operative Bank Ltd. & Ors. v. CIT & Anr. (supra) had held that the co-operative societies providing credit facilities to its members is entitled to deduction u/s 80P(2)(a)(i) of the Act. The Hon'ble Apex Court after considering the judicial pronouncements on the subject, had stated the term “member” has not been defined under the Income-tax Act. It was, therefore, stated by the Hon'ble Apex Court that the term “member” in*

the respective State Co-operative Societies Acts under which the societies are registered have to be taken into consideration. The Hon'ble Apex Court held that if nominal / associate member is not prohibited under the said Act, for being taken as a member, the income earned on account of providing credit facilities to such member also qualify for deduction u/s 80P(2)(a)(i) of the Act. It was further held by the Hon'ble Apex Court that section 80P(4) of the I.T. Act is to be read as a proviso. It was stated by the Hon'ble Apex Court that section 80P(4) of the Act now specifically excludes only co-operative banks which are co-operative societies engaged in the business of banking i.e. engaged in lending money to members of the public, which have a licence in this behalf from the RBI. The Hon'ble Apex Court had enunciated various principles in regard to deduction u/s 80P of the Act. On identical factual situation, the Bangalore Bench of the Tribunal in the case of M/s. Ravindra Multipurpose Cooperative Society Ltd. v. ITO in ITA No.1262/Bang/2019 (order dated 31.08.2021) had remanded the 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 Mavilayi Service Co-operative Bank Ltd. & Ors. v. CIT & Anr. (supra). The relevant finding of the Co-ordinate Bench of the Tribunal in the case of M/s. Ravindra Multipurpose Cooperative Society Ltd. v. ITO (supra), reads as follows:-

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

In respect of associate / nominal members, Hon'ble Supreme Court in the case of Mavilayi 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.”

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

3.1 The ld. A.R. submitted that the Hon'ble Supreme Court in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd., in Civil Appeal No.10069 of 2016, order dated 14.09.2023 has held that Central Co-operative Bank is a Co-operative Society which is registered under the Kerala State Co-operative Societies Act,

then it is not a bank per se governed by RBI, which is reproduced below:

*“15.8 Since the words 'bank' and 'banking company' are not defined in the NABARD Act, 1981, the definition in sub-clause (i) of clause (a) of section 56 of the BR Act, 1949 has to be relied upon. It states that a co-operative society in the context of a co-operative bank is in relation to or as a banking company. Thus, co-operative bank shall be construed as references to a banking company and when the definition of banking company in clause (c) of section 5 of the BR Act, 1949 is seen, it means any company which transacts the business of banking in India and as already noted banking business is defined in clause (b) of section 5 to mean the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise. Thus, it is only when a co-operative society is conducting banking business in terms of the definition referred to above that it becomes a co-operative bank and in such a case, section 22 of the BR Act, 1949 would apply wherein it would require a licence to run a co-operative bank. In other words, if a co-operative society is not conducting the business of banking as defined in clause (b) of section 5 of the BR Act, 1949, it would not be a co-operative bank and not so within the meanings of a state co-operative bank, a central co-operative bank or a primary co-operative bank in terms of section 56(c)(i)(cci). Whereas a co-operative bank is in the nature of a banking company which transacts the business of banking as defined in clause (b) of section 5 of the BR Act, 1949. **But if a co-operative society does not transact the business of banking as defined in clause (b) of section 5 of the BR Act, 1949, it would not be a co-operative bank.** Then the definitions under the NABARD Act, 1981 would not apply. If a co-operative society is not a co-operative bank, then such an entity would be entitled to deduction but on the other hand, if it is a co-operative bank within the meaning of section 56 of BR Act, 1949 read with the provisions of NABARD Act, 1981 then it would not be entitled to the benefit of deduction under sub-section (4) of section 80P of the Act.*

*15.9 section 56 of the BR Act, 1949 begins with a non-obstante clause which states that notwithstanding anything contained in any other law for the time being in force, the provisions of the said Act, shall apply to, or in relation to, co-operative societies as they apply to, or in relation to, banking companies subject to certain modifications. The object of section 56 is to provide a deeming fiction by equating a co-operative society to a banking company if it is a co-operative bank within the meaning of the said provision. This is because Chapter V of the BR Act, 1949, deals with application of the Chapter to co-operative societies which are co-operative banks within the meaning of the said chapter. For the purpose of these cases, what is relevant is that throughout the BR Act, 1949, unless the context otherwise requires, - references to a "banking company" or "the company" or "such company" shall be construed as references to a co-operative bank. **Therefore, while considering the meaning of a co-operative bank inherently, such a co-operative society must be a banking company then only it would***

be construed as a co-operative bank requiring a licence under section 22 of BR Act, 1949 in order to function as such a bank.

15.10 Further, while considering the definition of a co-operative bank under section 56(cci) of the BR Act, 1949, to mean a state co-operative bank, a central co-operative bank and a primary co-operative bank which is defined in (ccviii) thereof, to have meanings respectively assigned to them in the NABARD Act, 1981 would imply that if a state co-operative bank is within the meaning of NABARD Act, 1981 then it would be excluded from the benefit under section 80P of the Act. Conversely, if a co-operative society is not a co-operative bank within the meaning of section 56 of the BR Act, 1949, it would be entitled to the benefit of deduction under section 80P of the Act.”

3.2 Therefore, the ld. A.R. submitted that the Hon’ble Supreme Court has clearly stated that a state co-operative bank, a central co-operative bank or a primary co-operative bank in terms of section 56(c)(i)(cci) of the Act are not co-operative banks carrying on banking business i.e., the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise.

3.3 As regards the claim of deduction u/s 80P(2)(a) of the I.T. Act, we direct the A.O. to verify whether interest / dividend is received by the assessee out of investments made with Cooperative Societies. If the assessee earns interest / dividend income out of investments with co-operative society, as observed by Hon’ble Supreme Court in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd. Cited (supra), the same is entitled to deduction u/s 80P(2)(a) of the I.T. Act.

3.4 Without prejudice to the above, we make it clear that if the interest earned by assessee from the banks is considered under the head “Income from other sources”, relief to be granted to the assessee u/s 57 of the Act in accordance with law. Accordingly, the issue is restored to the file of ld. AO for de-novo consideration with the above observations.

4. In the next ground No.4, the assessee has challenged the disallowance of Provision of interest on deposit of Rs. 9,98,785/-. During the assessment proceeding, the AO found that the assessee

has accounted interest receipt on cash basis whereas it has debited the interest on deposit on accrual basis. The ld. CIT(A) observed that the assessee explained to the AO that it has followed accounting policies as per Karnataka State Co-operative Societies Act and provided interest payment as per Rule 22 of the Karnataka State Co-operative Societies Rule. The assessee's contention was not acceptable to AO. According to AO, as per Income tax Act, the assessee has to adopt either cash or mercantile system of accounting. The AO disallowed the excess provision interest of Rs. 9,98,785/-. During the appellate proceeding, the assessee reiterated its argument made before the AO that interest was provided as per Rule 22 of the Karnataka State Co-operative Societies Rule hence, it should be allowed. The ld. CIT(A) observed that as per section 1456 of the Act, the assessee has to follow either cash or mercantile system of accounting. The assessee's hybrid system of accounting was not allowable as per the Income Tax Act and therefore, the ld. CIT(A) has upheld the disallowance of Rs.9,98,785/-. Aggrieved, the assessee is in appeal before us.

5. We have heard the rival submissions and perused the materials available on record. We do not find any infirmity in the order of lower authorities on this issue as the assessee has to follow mercantile system or cash system of accounting in respect of one head of income. It cannot account interest receipt on cash basis and interest payment on mercantile system. The dual method is not allowed. Hence, we confirm the order of his lower authorities and dismiss the ground of appeal.

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6. In the result, appeal of the assessee is partly allowed for statistical purposes.

Order pronounced in the open court on 10th Apr, 2024

**(George George K.)
Vice President**

**(Chandra Poojari)
Accountant Member**

Bangalore,
Dated 10th Apr, 2024.
VG/SPS

Copy to:

1. The Applicant
2. The Respondent
3. The CIT
4. The DR, ITAT, Bangalore.
5. Guard file

By order

**Asst. Registrar,
ITAT, Bangalore.**