

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

**BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER  
AND  
SHRI SOUNDARARAJAN K., JUDICIAL MEMBER**

ITA No.93/Bang/2024
Assessment Year: 2017-18

Kavradi Co-operative Agricultural Bank Kandlur Kundapura Taluk Udupi 576 211 Karnataka  <b>PAN NO : AAABK0349L</b>	<b>Vs.</b>	ITO Ward-2 Udupi
<b>APPELLANT</b>		<b>RESPONDENT</b>

<b>Appellant by</b>	:	Sri Akshay K.S., A.R.
<b>Respondent by</b>	:	Shri Ganesh R. Ghale, Standing Counsel for department.

<b>Date of Hearing</b>	:	27.05.2024
<b>Date of Pronouncement</b>	:	10.06.2024

**O R D E R**

**PER SOUNDARARAJAN K., JUDICIAL MEMBER:**

This is an appeal filed by the assessee challenging the order of the NFAC dated 20.10.2023 passed u/s 250 of the Act for the assessment year 2017-18.

**2.** The brief facts of the case are that the assessee is a primary agricultural cooperative society registered under the Karnataka Co-operative Societies Act and they are in the business of providing credit facilities to its members. The assessee filed its return of income and declared a nil income after claiming the deduction u/s 80P of the Act. The case of the assessee was selected for complete scrutiny assessment under CASS and the assessment was made in which the assessing authority had disallowed the deduction claimed u/s 80P(2)(a)(i) of the Act on the ground that the assessee had

violated the provisions of the Karnataka Co-operative Societies Act. The ld. AO also held that the assessee has dealt with the nominal members and therefore, they are not entitled for deduction u/s 80P of the Act. Further, the ld. AO had disallowed the interest income earned from the co-operative banks and other banks since the same are against section 80P(2)(d) of the Act. Similarly, the ld. AO had disallowed the provision made for the interest expenses and held that the same is not eligible for deduction u/s 80P of the Act. The assessee filed an appeal before the NFAC and the NFAC had also confirmed the orders of the ld. AO by dismissing the appeal filed by the assessee. Therefore, the present appeal has been filed before this Tribunal challenging the above said order of the NFAC.

**3.** The ld. A.R. at the time of hearing submitted that there is no dispute with regard to the society being registered under the provisions of the Karnataka Co-operative Societies Act. The allegation that the nominal and associate members exceed the 15% of the regular members as per Section 18 of the Karnataka Co-op Societies Act is not correct since the provision says that the associate members should not exceed 15% of the total memberships. Moreover, the presence of nominal or associate members would not be a reason for disallowing the deduction u/s 80P(2)(a)(i) of the Act. The ld AR also relied on the judgement of the Hon'ble Supreme Court in the case of Mavilayi Service Co-operative Bank Ltd. Vs. CIT reported in (2021) 431 ITR 1 (SC). The ld. A.R. further contended that the AO cannot come to a conclusion that the assessee lost its cooperative status in view of the violation of the Cooperative Society provision. The ld AR further contended that the interest income received from the co-operative bank and other scheduled banks are eligible for deduction u/s 80P(2)(a)(i) of the Act since the interest income was obtained from the surplus funds deposited by the assessee and therefore the same is a business income. The ld. A.R. further contended that there is a statutory obligation to deposit 25% of the total deposits in the co-

operative banks and therefore the interest income received is eligible for deduction u/s 80P(2)(i) of the Act. The ld AR also submitted a statement in respect of the deposits made and contended that the interest income received on the statutory deposits are entitled for deduction u/s 80P(2)(i) of the Act. In respect of the disallowance of the provision for interest expenses, the ld. A.R. contended that as per Rule 22 of the Karnataka Cooperative Societies Rules the interest income should be accounted for on actual receipt basis whereas the interest expenses should be on accrual basis and therefore the assessee had uniformly followed the system in all the years and got the relief. The ld. AR contended that the same is in accordance with the provisions of the Karnataka State Co-operative Societies Act and Rules and eligible for deduction u/s 80P(2) of the Act. The ld. AR also relied on the order of the coordinated Bench of this Tribunal in the case of Sumangala Credit Cooperative Society Vs ITO (ITA No 383/Bang/2023 dated 07.09.2023. The ld AR finally submitted an alternate prayer, that the enhanced profits after making additions and disallowances should be eligible for deduction under Chapter VI A of the act as per the CBDT Circular No.37/2016.

**4.** The Ld. D.R. relied on the orders of the lower authorities and prayed to dismissed the appeal.

**5.** We have heard the rival submissions and perused the materials available on record. In this appeal, there are 3 issues and we dealt with each issue separately.

**5.1** The first issue relates to the disallowance of deduction claimed u/s 80P(2)(i) of the Act by the AO on the basis that the assessee had violated the provisions of the Karnataka Co-operative Societies Act by having more number of nominal and associate members than prescribed under section 18 of the Karnataka Co-operative Societies Act. We have perused the provision and found that the Act prescribed that the nominal members should not exceed 15% of the total members and not as stated by the ld AO. The statement of

membership filed by the assessee shows that the nominal members are within 15% of the total members prescribed under the statute and therefore there is no violation of any of the provisions of the Karnataka Act. Further we are of the view that the ld. AO has no jurisdiction to look into the fact whether there is any violation committed by the assessee under the provisions of the Karnataka Co-operative Societies Act. It is for the Registrar of Co-operative Societies to take any action on the assessee society, if there is any violation committed by them. Further the ld AO cannot disallow the claim of deduction and also disqualify the assessee as a Coop society for the reason that the assessee is dealing with the nominal members when there is no prohibition under the Act. The only condition prescribed under the Act is that the assessee should be a registered Coop. Society under the provisions of the Coop Societies Act. Admittedly the assessee is registered under the Karnataka Act and therefore the deduction can not be denied by citing other reasons. We find that the issue is fully covered by the judgement of the Hon'ble Supreme Court in the case of Mavilayi Service Co-operative Bank Ltd. Vs. CIT cited (supra). We therefore, find that there is no merit in the arguments made by the ld. D.R. and held that the order of the ld. AO is against the provisions of the Act and also against the judgement rendered by the Hon'ble Supreme Court.

**6.** The next issue is with regard to the disallowance of the interest income received from Co-operative banks. We have considered the argument made by the ld. A.R. that the deposits were made pursuant to the statutory obligation contained in the Karnataka Act and Rules. We also perused the circular issued by the Registrar of Coop. Societies in this regard. Further the ld. AR in their written submissions and in Gr 2.13 and 2.14 gave a statement about the Fixed deposits which is as follows:

2.13. In strict adherence to the stipulated provisions of the Karnataka Cooperative Societies Act, as well as the accompanying rules, the society is obligated to maintain liquid funds amounting to 25% of its total deposits plus a Statutory reserve of 25% out of the profits of each year as Reserve fund. The computation of this mandated limit for the year ended 31<sup>st</sup> March 2017 is as follows:

Particulars	Amount (Rs.)	Amount (Rs.)
Total Deposits as on 31.03.2017 (Sl. No.4 & 5 of Liabilities side of the Balance sheet)	10,34,59,902	
25% of the total deposits to be maintained as Liquid funds		2,58,64,975
Balance of Reserve fund as on 31.03.2017 (Show under Sl. No.2 of Liabilities Side)		44,35,246
<b>Total funds to be maintained</b>		<b>3,03,00,221</b>

2.14. The assessee has maintained the below deposits as on 31<sup>st</sup> March 2017:

Particulars	Amount (Rs.)
Investment in fixed deposits (Show under Sl. No.4 of Assets Side)	4,00,44,972
Funds that are Statutorily required	3,03,00,221
Excess funds (not statutorily required)	97,44,751

**6.1** As seen from the above table the assessee themselves admitted that the total statutory deposit is Rs 3,03,00,221 and the balance deposits of Rs 97,44,751 is not as per the statute. Therefore, the interest income generated from the statutory deposits are eligible for deduction u/s 80P(2)(i) of the Act. The balance non statutory deposits interest income should be taxed u/s 56 of the Act after granting deductions of cost of funds and administrative and other related expenses.

**6.2** We have also gone through the order of the coordinate Bench of the Tribunal in the case of M/s. S.K. Goldsmiths Industrial Co-

operative Society Ltd. Vs. ITO in ITA 771/Bang/2023 dated 12.12.2023 wherein this Tribunal held as under:

*“9. We have heard the rival submissions and perused the material on record. The first contention of the learned AR is that investments are made with the Central Co-operative Bank and is in compliance with the requirements under the Karnataka Co-operative Societies Act, 1959, and the relevant Rules. Therefore, it was contended that such interest income received on investments made under compulsion under the Karnataka Co-operative Societies Act, 1959, and the relevant Rules, is entitled to benefit of deduction under section 80P(2)(a)(i) of the Act. We find that this issue has been considered by the Bangalore Bench of the Tribunal in the case of M/s. Kachur Credit Co-operative Society Ltd., Vs. ITO (supra). The Bangalore Bench of the Tribunal had followed its earlier orders. The relevant finding of the Bangalore Bench of the Tribunal reads as follows:*

*“8. I have heard the rival submissions and perused the material on record. The solitary issue for adjudication is whether a sum of Rs.5,07,822/- can be allowed as a deduction under sections 80P(2)(a)(i) of the Act. Admittedly, the amount of Rs.5,07,822/- has been received by the assessee from South Canara District Central Co-operative Bank Ltd. It is the claim of the assessee that the amounts are invested in compliance with the relevant Acts and Rules. On identical facts, the Bangalore Bench of the Tribunal in the case of Bharat Co-operative Credit Society Vs. ITO (supra) by following the Co-ordinate Bench’s order in the case of Vasavamba Co-operative Society Ltd., Vs. PCIT in ITA No.453/Bang/2020 (order dated 13.08.2021) had stated that if the investments made with the Central Co-operative Bank is out of compulsions under Karnataka State Co-operative Societies Act, 1959 and Rules, the income received from such investments would be entitled to the benefit of deduction under section 80P(2)(a)(i) of the Act. The relevant finding of the Tribunal in the case of Bharat Co-operative Credit Society Vs. ITO (supra) reads as follows:*

*“7.1 In the instant case, it was contended that majority of the interest income is earned out of investments made with Cooperative Banks and is in compliance with the requirement under the Karnataka Co-operative Societies Act and Rules. If the amounts are invested in compliance with the Karnataka Co-operative Societies Act, necessarily, the same is to be assessed as income from business, which entails the benefit of deduction u/s 80P(2)(a)(i) of the I.T.Act. Insofar as deduction u/s 80P(2)(d) of the I.T.Act is concerned, we make it clear that interest income received out of investments with cooperative societies is to be allowed as deduction.”*

*9. In view of the above order of the Tribunal, I restore the issue to the files of the AO to examine whether interest income received amounting to Rs.5,07,822/- from South Canara District Central Co-operative Bank Ltd., is out of compulsions and in compliance with the Karnataka State Cooperative Societies Act, 1959 and the relevant Rules. If it is so, the same interest income is to be assessed as income from business which would entail the benefit of deduction under section 80P(2)(a)(i) of the Act. With the aforesaid observation, I restore the matter to the AO. It is ordered accordingly.”*

*10. In light of the above orders of the Tribunal, we direct the AO to examine whether the interest income received on investment with Central Co-operative Bank is out of compulsions under the Karnataka Co-operative Societies Act, 1959, and the relevant Rules. If it is so, the same may be considered as ‘business income’ and entitled to deduction under section 80P(2)(a)(i) of the Act. In other words, if assessee society does not comply with the relevant provisions of the Act, and the Rules of Karnataka Co-operative Societies Act, 1959, it cannot carry on its cooperative activities, namely carry on the business of banking or providing credit facilities to its members. Therefore, if the investments are out of compulsion under the Act and relevant Rules, necessarily it is part of assessee’s business activity entailing the benefit of section 80P(2)(a)(i) of the Act.”*

**6.3** The above order of the Co-ordinate bench of this Tribunal is on the very same facts and therefore , we set aside the order in respect of this portion and granted a similar relief by remitting the issue to the jurisdictional AO to examine whether the interest income received on investments with co-operative bank is out of compulsion under the provisions of the Karnataka Co-operative Societies Act and if so, the same may be considered under business income and the assessee is entitled for relief u/s 80P(2)(a)(i) of the Act after quantifying the correct income. In so far as the interest income received from other commercial banks the ld AO is directed to verify if there is any statutory compulsion, otherwise the same should be treated as income from other sources and the assessee is entitled for the cost of funds.

7. The third issue raised by the assessee is that whether the provision made for the interest expenses is eligible for deduction u/s 80P of the Act. We perused the provision and the other financial statements filed by the assessee and found that the assessee made provisions for interest expenses on an accrual basis which is in accordance with the accounting policies as prescribed under Karnataka Co-operative Societies Act. The Rule 22 of the Karnataka Co-operative Societies Rules specifies that interest income should be accounted for on an actual receipts basis while interest expenses should be recognized on an accrual basis. Therefore, the assessee, a registered society registered under the Karnataka Act, have to follow Rule 22 of the Karnataka Co-op. Societies Rules and therefore the method of accounting is in accordance with the Karnataka Rules and therefore the ld AO's allegation that they are employing hybrid system of accounting one for the interest income and the other for the interest expenses is not correct. We therefore held that the disallowance of the Provision for Net Interest Expenses is not correct. Further, the coordinate bench of this Tribunal in the case of Sumangala Credit Co-operative Society, Bantwal Vs. ITO in ITA No.383/Bang/2023 dated 7.9.2023 had held as follows:

*"6. We have heard the rival submissions and perused the materials available on record. Admittedly, in the assessment year under consideration, the assessee made gross provisions of Rs.1,77,20,374/-. Out of this, assessee deducted earlier assessment year provisions up to 31.3.2016 of Rs.1,40,63,514/-. Thus, additional provision charged to P&L account was Rs.36,56,860/-. This provision cannot be treated as unascertained liability as the provision has been made on the basis of regular method of accounting consistently followed by the assessee. In the present case, it is not disputed that assessee has been following mercantile system of accounting and interest accrued on deposit but not due as on date of 31.3.2017 to be provided in the books of accounts of the assessee and there was no question of mutuality, which cannot be applied herein and the interest accrued, which has been provided by the assessee in the books of accounts by following the mercantile accounting system of book keeping, the claim of assessee cannot be denied. Accordingly, we allow the claim of the assessee."*

**7.1** We therefore, find that this issue is in favour of the assessee and we allow the appeal of the assessee in so far as the provision made for the interest expenses are concerned.

**8.** In respect of the other two issues, i.e. the denial of the deduction u/s 80P(2)(i) of the Act and disallowance of the interest income received on the deposits made with Co Op Banks and other commercial banks, we are remitting the same to the file of ld. AO to consider the same afresh in accordance with law after giving an opportunity of being heard to the assessee.

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

Order pronounced in the open court on 10<sup>th</sup> June, 2024

**Sd/-**  
**(Waseem Ahmed)**  
**Accountant Member**

**Sd/-**  
**(Soundararajan K.)**  
**Judicial Member**

Bangalore,  
Dated 10<sup>th</sup> June, 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.**