

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

BEFORE SMT. BEENA PILLAI, JUDICIAL MEMBER
AND
SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER

ITA Nos. 577 to 580/Bang/2024
Assessment years : 2016-17 to 2018-19 & 2020-21

Kavu Primary Agricultural Credit Cooperative Society, 01, Kavu Vyavasaya Seva Sahakari Bank Ltd., Post Kavu Madnur. Puttur – 574 223. PAN : AACAK 7218B	Vs.	The Income Tax Officer, Ward 1, Puttur.
APPELLANT		RESPONDENT

Appellant by	:	Ms. Lakshmi S., Advocate
Respondent by	:	Shri Srinath S., Jt.CIT(DR)(ITAT), Bengaluru.

Date of hearing	:	08.05.2024
Date of Pronouncement	:	29.07.2024

ORDER

Per Laxmi Prasad Sahu, Accountant Member

This appeal is filed by the assessee against the separate orders of the CIT(Appeals), National Faceless Appeal Centre, Delhi [NFAC] dated 9.02.2024 for the AYs 2016-17 to 2018-19 and dated 12.02.2024 for AY 2020-21.

2. In all these appeals, there are similar disputes regarding deduction u/s. 80P(2) and classification of members and non-members.

The appeal for AY 2016-17 is the second round of proceedings before us. Since the issues involved are similar in all the appeals, we first take up AY 2016-17 in ITA No.577/Bang/2024 and the decision in this appeal shall apply mutatis mutandis to other appeals to the extent of issues involved.

3. Briefly stated the facts of the case for AY 2016-17 are that assessee filed return of income on 06.10.2016 declaring Nil income after claiming deduction of Rs.27,89,822 u/s. 80P. During the assessment proceedings, the AO noted that assessee had four class of members i.e., ordinary, Govt. members, nominal and associate members. The AO further noted that assessee has claimed deduction u/s. 80P amounting to Rs.27,89,822 and assessee has also received interest and dividend from various entities as under:-

Deposit with South Canara Dist. Coop. Bank	- Rs.70,17,051
Deposit with SBI	- Rs. 9,906
Shares in South Canara Dist. Coop. Bank	- Rs. 3,97,178

4. The AO after examining the documents submitted noted at para No. 05 of his order that there is differential rights among the different class of members and accordingly disallowed the deduction u/s. 80P(2)(a)(i) of the Act relying on the judgment in the case of Citizen Cooperative Society Ltd. (2017) 397 ITR 1 and noted that there is violation of principle of mutuality by the assessee after referring to section 2(19) of the Income Tax Act. The AO also relied on other various judgments and did not allow deduction u/s. 80(P)(2)(d) of the

Act. He allowed only 10% of the interest income earned as incidental expenses and completed the assessment.

5. Aggrieved from the above order of the AO, the assessee filed appeal before the CIT(Appeals) and submitted written submissions which was considered and he upheld the order of the AO. Aggrieved, the assessee is in appeal before the ITAT.

6. The Id. AR reiterated submissions made before the lower authorities and submitted that assessee is eligible for deduction u/s 80P(2)(a)(i) as per judgment of Hon'ble Apex Court in Mavilayi Service Co-op. Bank Ltd. [2021] 123 taxmann.com 1 (SC) wherein it is held that primary agricultural co-operative societies is entitled to the benefit of deduction u/s. 80P(2)(a)(i) of the Act on interest income earned from lending to members including nominal members, however the revenue authorities have not considered the interest received from nominal members for the eligibility of deductions. She further submitted that interest received from the investments is also eligible for deduction u/s 80(P)(2)(a)(i) of the Act because it was invested as per the direction issued by the Registrar of Cooperative Societies for maintaining liquidity ratio against the deposits received from the members as per Karnataka Cooperative Societies Act/Rules. Therefore it should be considered as business income for providing credit facilities to its members. She further submitted that the assessee is a primary agricultural co-operative society engaged mainly in the business of providing credit facilities to its members and providing

financial aids as well as agricultural implements, seeds, fertilizers, pesticides etc. The assessee has earned interest on investments out of its operational fund used in business of lending to its members and not by investing surplus funds in short term deposits. The Id. CIT(A) has wrongly applied the judgment of Hon'ble Apex Court in the case of Totgars Co-operative Sale Society [2010] 322 ITR 283 and not considered that investment in co-operative bank is a statutory requirement under Karnataka Co-operative Societies Act, 1959. Hence it is attributable to carrying on of normal business activity and society is eligible for deduction u/s. 80P(2)(a)(i) of the Act.

7. The Id. AR further submitted that interest income received on assessee's investments to another co-operative society are also eligible for deduction u/s. 80P(2)(d) because the co-operative banks are primarily co-operative societies as specified in section 80P(2)(d). She further submitted that interest income earned should not be taxed under the head income from other sources and it should be considered as business income. Even the assessee has not been granted deduction u/s. 80P(2)(d). The Id. CIT(A) has also not decided the issue in the light of Hon'ble Supreme Court judgment in the case of Kerala State Cooperative Agricultural and Rural Development Bank Ltd. in Civil Appeal No.10069/2016, order dated 14.09.2023 in which it has been held that co-operative bank is a co-operative society which is registered under Kerala Co-operative Societies Act and it is not a bank per se governed by RBI. Alternatively she submitted that if the deduction is not granted to the assessee u/s. 80(P)(2)(a)(i)/80P(2)(d) on

such interest income received from cooperative bank, the cost of funds towards earning of interest income should be granted to the assessee, the cost of funds granted by the AO is not sufficient to earn such interest income and requested that the matter may be sent back to the AO for fresh consideration. In support of his argument, the assessee relied on the following decisions:

- (i) Mavilayi Service Co-op. Bank Ltd. [2021] 123 taxmann.com 1 (SC).
- (ii) Canara Bank Staff Credit Co-op. Societies Ltd. in ITA No. 517/Bang/2023.
- (iii) M/s. Charvaka Seva Sahakari Bank Ltd. in ITA No.901/Bang/2023.
- (iv) M/s. Primary Agricultural Credit Co-operative Society Ltd. v. ITO, Puttur (ITA 1006/Bang/2023)
- (v) Vittal Grameena Sahakari Bank Niyamitha, ITA No.895/Bang/2023.

8. The Ld. DR relied on the order of the Ld.CIT(A) and he submitted that the interest income received by the assessee is not to be considered as a business income since the Hon'ble Jurisdictional High Court of Karnataka has settled this issue in the case of Totgars' Co-operative Sales Society Ltd. reported in (2017) 395 ITR 611 (Karnataka) dated 16.06.2017.

9. The Id. DR also submitted that in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd. KSCARDB vs. Assessing Officer, (2023) 154 taxmann.com 305 the Hon'ble Supreme Court has clearly held that if the payer bank holds licence from RBI for carrying out banking business, then the interest received

from such bank is not eligible for deduction u/s. 80P(2)(d), though the co-operative bank may be primarily formed as co-operative society and that the activity of the entity should be seen. He submitted that the interest received from co-operative bank is governed by Banking Regulation Act, 1949. Though the assessee was required to deposit certain amount of its deposits as per the Karnataka co-operative society Act for maintain liquidity ratio and earned interest on such deposits but the interest income is not eligible for deduction u/s 80P(2)(a)(i) because the interest was not received from providing credit facilities to its members and investee bank is not a members in terms of definition of members as per bylaws of the society. The character of interest income received from its investments cannot be treated as business income even if is compulsion for investments. The lower authorities have rightly allowed cost of funds. The case law relied by the Id. AR is not applicable in the present facts of the case. The Karnataka Co-operative Society Act and Rules cannot override the income tax provisions. The Id. DR further submitted that the case law relied by the assessee in ITA No.547, 548, 599/Bang/2024 order dated 17.5.2024 is not applicable since the Act should be read with literal interpretation. Section 80{P}(2)(a)(i) is very clear that income earned from carrying on the business of banking or providing credit facilities to its members is eligible for deduction and there is no ambiguity in the section.

10. Considering the rival submissions, we note that the assessee is registered under Karnataka Co-operative Society Act 1959, we note

that here the issue is that whether the assessee is eligible to claim of deduction u/s. 80P(2)(a)(i) on interest income received from credit facilities provided to the different class of its members and 80P(2)(d) on the interest income earned on its investments made with District co-operative banks. The Ld.CIT(A) has not accepted the claim of the assessee by relying on the judgment of Hon'ble Karnataka High Court in case of Totgars' Co-operative Sales Society Ltd. (supra) and Hon'ble apex court's decision in the case of Citizens Co-operative Society Ltd.

11. We note that during the course of assessment proceedings, the AO asked to submit details as per notice u/s 142(1) and the AO noted that assessee has regular/normal members and nominal members and they have classified Class "A", "B", "C" & "D" members. The nominal/associate members (Class C & D) have no role in the management of society, have no voting rights & no entitlement for share in the assets or profits. The sec. 20(2)(a) of the Karnataka Co-operative Society Act denies any right to vote to a nominal or associate members. Further the Nominal/Associate members are not entitled to attend the general meetings of the society, not eligible to contest on election. The assessee is doing business with non-members and the profit from such business is divided among the regular members of the society. The ld. DR submitted that as per the Karnataka Co-operative Society Act sec. 18 amended by the Act 2014, the associated/nominal members should not exceed 15% of the regular members, if it exceeds, then it has to be regularized within the period of six months. We note

that the lower authorities have disallowed deduction on interest income received from providing credit facilities from all the members by following the judgment of Hon'ble Apex Court in the case of Citizen Co-operative Society Ltd., Hyderabad Vs. ACIT noted supra. The decision relied on by the Id. AR in the case of Mavilayi Service Co-operative Bank Ltd., (supra) is under Kerala Co-operative Societies Act in which it has been held that proportionate deduction u/s. 80P(2)(a)(i) should be granted to the assessee from the interest income received from providing credit facilities to its members but not from the non-members. The Para 33 of the said judgement says as under:-

“.....Once it is clear that the co-operative society in question is providing credit facilities to its members, the fact that it is providing credit facilities to non-members does not disentitle the society in question from availing of the deduction. The distinction between eligibility for deduction and attributability of amount of profits and gains to an activity is a real one. Since profits and gains from credit facilities given to non-members cannot be said to be attributable to the activity of providing credit facilities to its members, such amount cannot be deducted.”

The ratio of Hon'ble Apex Court in the case of Mavilayi Service Co-operative Bank Ltd., (supra) is very much applicable for computing the income attributable to the business of the assessee among the members and non-members. The assessee is governed by Karnataka Co-operative Societies Act, 1959 and assessee has to follow section 18 (amended) Act of 2014 and bye-laws of the society. We note that AO in para 5 has observed that nominal members do not have a right in share of profits of the assessee. The AO has to examine with the

bylaws of the Society in regard to classification of members, their rights, sharing of profits of the society among the members (Regular/Nominal). In the event it is found that the nominal/associate members are not members as per bylaws of the society, then the proportionate deduction u/s 80P(2)(a)(i) to be granted in terms of the judgment of Hon'ble Apex Court in the case of Mavilayi Service Co-operative Bank Ltd., (supra) on such income. The assessee is directed to produce before the AO the quantum of interest income received from all the members categorywise ("A","B","C" & "D") for calculating correct deduction u/s 80P(2)(a)(i) of the Income Tax Act. Accordingly we remit this issue to the AO for afresh consideration and determination of the interest received from members and non-members from providing credit facilities and decide the issue as per law. Accordingly this issue is partly allowed for statistical purpose.

12. During the course of hearing, the Ld.AR of the assessee relied on the Circular No. 18/2015 dated 02.11.2015 and submitted that as per the provisions of the Karnataka Co-operative Societies Act, the assessee is required to maintain SLR from the deposits received from the members and has to invest 100% from the general reserve and 25% from the deposits collected from members as per rule 28 of the Karnataka Cooperative Society Rules 1960. Accordingly, assessee has invested in the fixed deposits. As per the circular, the income received from the investments should be treated as business income u/s. 28 and assessee is eligible to make a claim of deduction u/s. 80P(2)(a)(i) as business income. Further, the assessee also submitted that the

investments were made in co-operative banks which are co-operative society, therefore it is eligible for deduction u/s 80P(2)(d). It is submitted by the Id. AR that interest received on such investments are to be allowed for deduction u/s. 80P(2).

13. We note from plain reading of Circular No. 18/2015 dated 02.11.2015 it is applicable to those co-operative societies / co-operative banks in which the Banking Regulation Act, 1949 applies. During the course of hearing the assessee was asked to submit the requirement of SLR as per Karnataka Cooperative Societies Act/Rules 28 and the quantum and period for calculating SLR, the assessee was unable to give reply. Rule 23 of the Karnataka Co-operative Societies Rules states that reserve fund belongs to the society and is intended to meet the unforeseen losses. Further if the cooperative society wants to invest reserve fund or any portion thereof for any other purpose as prescribed under section 58 (a) to (d) of the Karnataka Co-operative Societies Act permission is to be taken from the Registrar of Co-operative Societies. Even if the maintainability of SLR requirement is out of internal fund/external funds then no deduction shall be allowed u/s. 80P(2)(a)(i), since the interest income received on such investments from co-operative banks is not attributable to main business of the appellant as prescribed in the section. The issue regarding the word “attributable” has been discussed elaborately by the Hon’ble Apex Court in the case of M/s Totgar’s Co-operative Sales Society (2010) reported in [2010] 188 Taxman 282 (SC) where it is held by the Hon’ble Supreme Court that the deduction u/s 80P is

available only to the income which is attributable to the business operation. Admittedly, it is a matter of fact borne from the record that the legislature in all its wisdom had inserted the provisions of Section 80P(2)(a)(i) of the Act as a part of deductions from carrying on the business of banking or providing credit facilities to its members by a Co-operative Society. Although the contention of the Ld. AR that interest received from deposit under compulsion is to be considered u/s 80P(2)(a)(i), the AO considered it as income u/s 56 of the Act. As per our considered opinion, going by the rule of literal interpretation that has to be adopted while construing the scope and gamut of a statutory provision, the same does not merit acceptance. As Section 80P(2)(a)(i) does not carve out any exception as regards the applicability of the same in a case where the investments are made under compulsion or as per any direction from Registrar of co-operative society, the aforesaid contention of the Ld. AR that the same could be considered for deduction u/s. 80P(2)(a)(i) cannot be accepted. This view of ours that statutory provision has to be construed as per the rule of literal interpretation is supported by the judgment of the Hon'ble Supreme Court in the case of *New Noble Educational Society v. Chief CIT* [2022] 143 taxmann.com 276/[2023] 290 Taxman 206/[2023] 448 ITR 594/[CA No. 3793 to 3795 of 2014 dated 19-10-2022]. The Hon'ble Apex Court observed that if the language is unambiguous and capable of only one meaning, that alone should be applied and not any other, based on the surmise that the legislature intended it to be so. In other words, it is only in case of ambiguity that the court can use other

aids to discern the true meaning, but where the statute is clear and the words are plain, the legislation has to be given effect in its own terms. Since, in the case of the assessee interest income received is from investments from Banks which cannot be attributed to the main business of providing credit facilities to its members, same cannot be held to be allowable as deduction u/s 80P(2)(a)(i) of the Act.

14. The assessee has also raised issue that the deduction should be allowed to the assessee u/s 80P(2)(d) on such interest income received from its investments. For the sake of convenience we are reproducing the section 80P(2)(d) as under:-

80P. (1)

(2) The sums referred to in sub-section (1) shall be the following, namely :—

(d) in respect of any income by way of interest or dividends derived by the co-operative society from its investments with any other co-operative society, the whole of such income;

We note from the order of the AO that the assessee has invested its funds in commercial bank as well as in co-operative banks and earned interest thereon. Section 80P(2)(d) describes that if the assessee has received interest from the co-operative society, then the assessee is eligible for claim of deduction on such interest “derived” under the said provision. In the judgment of Hon’ble Apex Court in the case of Kerala State Co-operative Agricultural and Rural Development Bank Ltd. (KSCARDB) vs. The Assessing Officer, Trivandrum & Ors. (2023) 154 taxmann.com 305 (Supreme Court) it has been discussed in

detail the definition of co-operative banks and co-operative society. If the payer bank falls under the definition of co-operative bank/ bank in the light of the judgment of Hon'ble Apex Court then the assessee is not eligible to get deduction u/s. 80P(2)(d) on such interest income received from co-operative banks. We note that the assessee has also received interest from co-operative banks which is governed by the Banking Regulation Act of 1949 and this argument of the Id. DR has not been denied by the Id. AR of the assessee. However it is not clear whether the interest payer (co-operative bank) is a bank and registered with Reserve Bank of India and holding licence from RBI for carrying out banking business as per RBI Act. If the payer bank falls under the definition of co-operative bank in the light of the judgment of Hon'ble Apex Court then the assessee is not eligible to get deduction u/s. 80P(2)(d) on such interest income received from co-operative banks, therefore this issue is also remitted back to the AO for verification of interest received from co-operative bank in above terms. If AO finds that the co-operative bank is carrying its banking business activities in the light of the above judgment, the deduction u/s. 80P(2)(d) on such interest income should not be granted.

15. We further note that the assessee has received interest from other co-operative banks/commercial banks on its investments. The revenue authorities have considered expenditure u/s 57(iii) to the extent of 10% of the interest/dividend income earned and treated the balance as income from other sources u/s. 56 including the interest received from co-operative bank. While calculating the income, the net income

should be considered as taxable income after reducing the expenditure incurred towards earning of such income. During the assessment proceedings the assessee submitted calculation of cost of funds but the AO has not accepted. Considering the involvement of internal and external funds for investments it requires fresh consideration. Therefore relying on the judgment of Hon'ble Jurisdictional High Court in case of Totgars' Co-operative Sales Society Ltd. vs ITO Sirsi, reported in (2015) 58 taxmann.com 35 (Karnataka), the assessee is eligible for claim of its cost of funds on the interest income received from banks. Since in the case on hand the assessee has been allowed cost of funds to the extent of Rs. 7,42,413/- and taxable income under the head income from other sources is Rs. 66,81,722/-, Therefore, we are remitting this issue to the file of AO for fresh computation of cost of funds. Accordingly, the assessee is directed to provide the details of cost of funds before the assessing officer.

16. In the result, the appeal of the assessee is allowed for statistical purposes. Following the same, on similar facts the other appeals in ITA Nos.578 to 580/Bang/2024 of the assessee are also allowed for statistical purposes in above terms.

Pronounced in the open court on this 29th day of July, 2024.

Sd/-
(BEENA PILLAI)
JUDICIAL MEMBER

Sd/-
(LAXMI PRASAD SAHU)
ACCOUNTANT MEMBER

Bangalore,
Dated, the 29th July, 2024.

/Desai S Murthy /

Copy to:

1. Appellant
2. Respondent
3. Pr.CIT
4. CIT(A)
5. DR, ITAT, Bangalore.

By order

Assistant Registrar
ITAT, Bangalore.