

**IN THE INCOME TAX APPELLATE TRIBUNAL  
SMC-'B' BENCH : BANGALORE**

**BEFORE SHRI LAXMI PRASAD SAHU, ACCOUNTANT MEMBER  
AND  
SHRI SOUNDARARAJAN K., JUDICIAL MEMBER**

<b>ITA No. 1345/Bang/2024</b>
<b>Assessment Year : 2017-18</b>

M/s. Gurumachideva Vividhodesha Sahakara Sangha Ltd., Medicare Building, Court Back Road, Udupi – 576 101. <b>PAN: AABAG0591Q</b>	<b>Vs.</b>	The Income Tax Officer, Ward – 1 & TPS, Udupi.
<b>APPELLANT</b>		<b>RESPONDENT</b>

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

Date of Hearing	:	17-10-2024
Date of Pronouncement	:	10-01-2025

**ORDER**

**PER SOUNDARARAJAN K., JUDICIAL MEMBER**

This is an appeal filed by the assessee challenging the order of the NFAC, Delhi dated 01/04/2024 in respect of the A.Y. 2017-18 on the following grounds :

- “1. Whether the appellate authority was justified in sustaining the addition in respect of -*
- (a) differential provision for interest payable on deposits of Rs. 3,00,176/- on the ground that appellant was following Hybrid system of accounting; and*
  - (b) debits found in the audited Profit & Loss A/c of the appellant, viz: N.P.A. provision Rs. 1,50,000/-, Pension*

*Fund Rs. 85,000/- and Stamp Duty provision Rs. 19,000/- aggregating to Rs. 5,54,176/- in the impugned order;*

*2. Whether or not the addition sustained in appeal opposed to Sec. 40A(7) and Sec. 43(2) of the Act and run contrary to :*

*(a) CBDT Circular No. 37/2016 dated 02-11-2016 which gives the relief in respect of any disallowance of business expenditure by way of deduction under Chapter VI A of the Act to the extent profits so enhanced by such disallowance; and*

*(b) the decision of Hon. Bombay High Court in C.I.T. vs. M/s. Gem Plus Jewellery India Ltd. and also the decision of this Tribunal in ITA No. 436/Bang/2023 in Shreerama Credit Co-op. Society Ltd. Kundapura vs. ACTT, Circle 1, Udupi.*

*3. The appellant craves leave to add, to amend, modify and / or to alter any of the foregoing grounds and also urge such other grounds at the time of hearing.”*

**2.** The assessee is a co-operative society and filed its return of income on 24/10/2017 and claimed a deduction u/s. 80P(2)(a)(i) of the Act. The AO not accepted the deduction for the reason that the assessee had mostly dealt with the non-members. Similarly, the AO had added the excess provision of interest since the assessee had followed the hybrid system of accounting. The provision for registration, pension fund and provision for bad debts were also disallowed and added to the total income. As against the said order, the assessee filed an appeal before the Ld.CIT(A) and contended that the nominal members are also members of the society and therefore dealing with them could not be treated as dealing with the public and the benefit should not be denied on that basis. The assessee further contended that the excess provision of interest is also eligible for deduction since the assessee had followed the accounting method mandated under the provisions of Karnataka Co-operative Societies Act. In respect of the other provisions, the assessee submitted that even after this addition, the net profits gets increased and in effect the entire profit will again qualify for deduction and therefore prayed to allow the appeal. The assessee also relied on section 40A(7)(b) of the Act. The Ld.CIT(A) considered the grounds raised

by the assessee insofar as the disallowance of interest income earned by the assessee and allowed the same by holding that the business carried on with the nominal members would not be a reason for allowing the disallowance claimed u/s. 80P(2)(a)(i) of the Act. In coming to the said conclusion, the Ld.CIT(A) relied on the orders of the Coordinate Bench of this Tribunal as well as the judgment of the Hon'ble Jurisdictional High Court. Insofar as the excess provision of interest is concerned, the Ld.CIT(A) had confirmed the addition for the reason that dual accounting system could not be followed. In respect of the other provisions, the Ld.CIT(A) had confirmed the said disallowance for the reason that the assessee had not provided any evidence to show that the provisions are ascertained liabilities. As against the additions confirmed by the Ld.CIT(A), the assessee has filed this present appeal before this Tribunal.

**3.** At the time of hearing, the Ld.AR brought to our notice Rule 22 of the Karnataka Co-operative Societies Rules and contended that the method adopted by the assessee is in accordance with the said Rules and therefore the addition made is not correct. The Ld.AR also relied on the order of the Coordinate Bench of this Tribunal in ITA No. 93/Bang/2024 dated 10.06.2024 in the case of Kavradi Co-operative Agricultural Bank vs. ITO in support of his submission. Insofar as the other provisions, the assessee relied on section 40A(7)(b) of the Act and prayed to allow the appeal.

The Ld.DR relied on the orders of the lower authorities and prayed to dismiss the appeal.

**4.** We have heard the arguments of both sides and perused the materials available on record.

**5.** We have also perused the order of the Coordinate Bench of this Tribunal relied on by the Ld.AR in support of his contention that the assessee had followed the method prescribed under Rule 22 of the Karnataka Co-operative Societies Rules in which it was held as follows:

“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.”

**6.** In view of the above said finding given by the Coordinate Bench of this Tribunal, we are also following the principle laid down in that order and thereby delete the addition made in respect of the excess provision of interest.

In so far as the other provisions made and claimed u/s 40A(7) (b) of the Act is concerned, we will first consider the relevant provision which reads as follows:

***“Expenses or payments not deductible in certain circumstances.***

***40A.***

.....

.....

.....

*(7) (a) Subject to the provisions of clause (b), no deduction shall be allowed in respect of any provision (whether called as such or by any other name) made by the assessee for the payment of gratuity to his employees on their retirement or on termination of their employment for any reason.*

*(b) Nothing in clause (a) shall apply in relation to any provision made by the assessee for the purpose of payment of a sum by way of any contribution towards an approved gratuity fund, or for the purpose of payment of any gratuity, that has become payable during the previous year.*

*Explanation.—For the removal of doubts, it is hereby declared that where any provision made by the assessee for the payment of gratuity to his employees on their retirement or termination of their employment for any reason has been allowed as a deduction in computing the income of the assessee for any assessment year, any sum paid out of such provision by way of contribution towards an approved gratuity fund or by way of gratuity to any employee shall not be allowed as a deduction in computing the income of the assessee of the previous year in which the sum is so paid.”*

**7.** Insofar as the addition made in respect of the provision for bad debts, pension fund and registration, the assessee relied on section 40A(7)(b) of the Act. Further there is a clarification issued in Circular No. 37/2016 dated 02/11/2016 which reads as follows:

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**CIRCULAR NO.37/2016 [F.NO.279/MISC./140/2015/ITJ]****80-IA OF THE INCOME-TAX ACT, 1961 - DEDUCTIONS - PROFITS AND GAINS FROM INFRASTRUCTURE DEVELOPMENT UNDERTAKINGS - CHAPTER VIA DEDUCTIONS ON ENHANCED PROFITS****CIRCULAR NO.37/2016 [F.NO.279/MISC./140/2015/ITJ], DATED 2-11-2016**

Chapter VI-A of the Income-tax Act, 1961 ("the Act"), provides for deductions in respect of certain incomes. In computing the profits and gains of a business activity, the Assessing Officer may make certain disallowances, such as disallowances pertaining to sections 32, 40(a)(ia), 40A(3), 43B etc., of the Act. At times disallowance out of specific expenditure claimed may also be made. The effect of such disallowances is an increase in the profits. Doubts have been raised as to whether such higher profits would also result in claim for a higher profit-linked deduction under Chapter VI-A.

2. The issue of the claim of higher deduction on the enhanced profits has been a contentious one. However, the courts have generally held that if the expenditure disallowed is related to the business activity against which the Chapter VI-A deduction has been claimed, the deduction needs to be allowed on the enhanced profits. Some illustrative cases upholding this view are as follows:

(i) If an expenditure incurred by assessee for the purpose of developing a housing project was not allowable on account of non-deduction of TDS under law, such disallowance would ultimately increase assessee's profits from business of developing housing project. The ultimate profits of assessee after adjusting disallowance under section 40(a)(ia) of the Act would qualify for deduction under section 80-IB of the Act. This view was taken by the courts in the following cases:

- ◆ *Income-tax Officer -Ward 5(1) v. Keval Construction* [2013] 33 taxmann.com 277 (Guj.)
- ◆ *Commissioner of Income-tax-IV, Nagpur v. Sunil Vishwambharnath Tiwari* [2016] 63 taxmann.com 241 (Bom.)

(ii) If deduction under section 40A(3) of the Act is not allowed, the same would have to be added to the profits of the undertaking on which the assessee would be entitled for deduction under section 80-IB of the Act. This view was taken by the court in the following case:

- ◆ *Principal CIT, Kanpur v. Surya Merchants Ltd.* [2016] 72 taxmann.com 16 (All.).

The above views have attained finality as these judgments of the High Courts of Bombay, Gujarat and Allahabad have been accepted by the Department.

3. In view of the above, the Board has accepted the settled position that the disallowances made under sections 32, 40(a)(ia), 40A(3), 43B, etc. of the Act and other specific disallowances, related to the business activity against which the Chapter VI-A deduction has been claimed, result in enhancement of the profits of the eligible business, and that deduction under Chapter VI-A is admissible on the profits so enhanced by the disallowance.

4. Accordingly, henceforth, appeals may not be filed on this ground by officers of the Department and appeals already filed in Courts/Tribunals may be withdrawn/not pressed upon. The above may be brought to the notice of all concerned.

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8. In the above said circular, the Board had clarified that how the disallowances made under the provisions could be claimed under Chapter VIA of the Act since the disallowances would result in enhancement of profits of the eligible businesses and therefore the deduction under Chapter VIA is admissible on the profits so enhanced by the disallowance. The above said circular was not considered by the AO while disallowing the expenses and therefore we are remitting this issue to the file of AO to consider the circular to the facts and circumstances of the case and thereafter decide the

issue afresh after giving a reasonable opportunity of being heard to the assessee.

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

Order pronounced in the open court on 10<sup>th</sup> January, 2025.

Sd/-  
(LAXMI PRASAD SAHU)  
Accountant Member

Sd/-  
(SOUNDARARAJAN K.)  
Judicial Member

Bangalore,  
Dated, the 10<sup>th</sup> January, 2025.  
/MS /

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|---------------|------------------------|
| 1. Appellant  | 2. Respondent          |
| 3. CIT        | 4. DR, ITAT, Bangalore |
| 5. Guard file | 6. CIT(A)              |

By order

Assistant Registrar,  
ITAT, Bangalore