IN THE INCOME TAX APPELLATE TRIBUNAL
'B' BENCH, BANGALORE

BEFORE SHRI WASEEM AHMED, ACCOUNTANT MEMBER AND
SHRI KESHAV DUBEY, JUDICIAL MEMBER

ITA No. 1927 & 1943/Bang/2024
Assessment Years : 2017-18 & 2018-19

The Belthangady Co-operative Agricultural Sangha Limited, Court Road, Belthangady – 574 214. **PAN – AAAJB 0230 D**	Vs.	The Income Tax Officer, Ward - 1, Puttur. .
APPELLANT		RESPONDENT

Assessee by	:	Shri Krishna Kantila, C.A
Revenue by	:	Shri Ganesh R Ghale, Standing Counsel for Dept. (DR)

Date of hearing	:	20.01.2024
Date of Pronouncement	:	28.01.2025

O R D E R

PER WASEEM AHMED, ACCOUNTANT MEMBER:

These appeals filed by the assessee are against the order passed by the NFAC, Delhi dated 06/08/2024 and 12/08/2024 respectively for the assessment years 2017-18 and 2018-19.

First, let us take up ITA No. 1927/Bang/2024 for the asst. year 2018-19

2. The interconnected issue raised by the assessee in ground Nos. 1 to 3 is that the ld. CIT-A erred in conforming the disallowance made by the AO under the provisions of section 80P(2)(a)(i) of the Act.

3. Briefly stated facts are that the Assessee is an Agricultural Co-Operative Society registered under the Karnataka Co-Operative Societies Act, 1959. The Society is engaged in accepting deposits from members and lending the same to its members. For the relevant assessment year, the Assessee filed a return of income declaring NIL income after claiming a deduction of Rs. 31,04,741 under Section 80P(2)(a)(i) of the Income Tax Act, 1961.

4. During scrutiny assessment proceedings, the Assessing Officer (AO) observed that the membership structure of the society consists of:

> A Class Members: Regular members who actively participate in management.
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> B Class Members: State Government shareholders.
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> C & D Class Members: Nominal and associate members without voting rights.

5. Based on the above, the AO observed that the assessee is having nominal members 3 time more than its Class A members. Nominal members have no voting right and management & control. Likewise, they are not eligible for share in the profit whereas the society earns profit by granting loan to such members. Therefore, the society violates the principles of mutuality**.** The AO also noted that the number of nominal members exceeds 15% limit set under section 18 of the

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Karnataka Co-operative Societies Act, 1959, as amended on 06.09.2014**.** Based on the above observations, the AO disallowed the deduction under Section 80P(2)(a)(i)**,** of the Act.

6. Aggrieved assessee preferred an appeal before the Ld. CIT(A) who allowed proportionate deduction for income earned from loans and credit facilities granted to regular members only.

7. Being aggrieved by the order of the Ld. CIT(A), the assessee is in appeal before us.

8. The Ld. Authorized Representative (AR) contended that the society is a cooperative entity formed to provide credit facilities to members and that section 80P(2)(a)(i) of the Act grants a blanket deduction to cooperative societies engaged in such activities.

9. The Assessee relied on the Hon'ble Supreme Court's decision in Mavilayi Service Co-operative Bank Ltd. v. CIT (2021) 123 taxmann.com 161 (SC)**,** wherein it was held that the presence of nominal members does not render a cooperative society ineligible for deduction under Section 80P(2)(a)(i) of the Act unless there is an express finding that it was carrying out banking activities akin to a commercial entity.

10. The Assessee further submitted that Section 80P(2)(a)(i) does not distinguish between different categories of members. The Karnataka Co-operative Societies Act, 1959, permits the inclusion of nominal members for operational flexibility. The society does not conduct business with the general public and only provides credit to registered members**.**

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11. On the other hand, the Ld. DR supported the order of the authorities below. Without prejudice, the DR also contended that the issue to examine the class of members can be set aside to the AO for fresh examination as per the provisions of law.

12. We have carefully considered the rival submissions of both parties and perused the materials on record. The fact as undisputed that assessee is a co-operative society and now only issue remaining is that whether the Nominal member of the society will be considerd as member for the computing the deduction u/s 80P of the Act. In this regard, we note that as per the provisions of section 2(f) of the Karnataka Co-Operative Society, member include the Nominal and associate member, the relevant portion of the section is reproduced as under:

> *"member" means a person joining in the application for the registration of a co-operative society and a person admitted to membership after such registration in accordance with this Act, the rules and the bye-laws and includes a nominal and an associate member;*

12.1 Thus, the nominal and associate member will also be treated as member while computing the deduction u/s 80P(2)(a)(i) of the Act. In holding so, we draw support and guidance from the judgment of Hon'ble Supreme Court in the case of Mavilayi Service Co-operative Bank Ltd. reported in 123 taxmann.com 161 which has categorically held that the presence of nominal members does not disentitle a cooperative society from claiming deduction under Section 80P(2)(a)(i) of the Act. The Hon'ble Court emphasized that the crucial test is whether the society is providing credit facilities to members and whether it is functioning as a

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cooperative society, not as a commercial bank. We reproduce the relevant para of the judgment as under:

> *"8. The expression "members" is not defined in the Act. Since a cooperative society has to be established under the provisions of the law made by the State Legislature in that regard, the expression "members" in Section 80-P(2)(a)(i) must, therefore, be construed in the context of the provisions of the law enacted by the State Legislature under which the cooperative society claiming exemption has been formed. It is, therefore, necessary to construe the expression "members" in Section 80-P(2)(a)(i) of the Act in the light of the definition of that expression as contained in Section 2(n) of the Cooperative Societies Act. The said provision reads as under:*
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> *"2. (n) 'Member' means a person who joined in the application for registration of a society or a person admitted to membership after such registration in accordance with the provisions of this Act, the rules and the bye-laws for the time being in force but a reference to 'members' anywhere in this Act in connection with the possession or exercise of any right or power or the existence or discharge of any liability or duty shall not include reference to any class of members who by reason of the provisions of this Act do not possess such right or power or have no such liability or duty;""*
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> *Considering the definition of 'member' under the Kerala Act, loans given to such nominal members would qualify for the purpose of deduction under section 80P(2)(a)(i).*

12.2 It is also undisputed facts that the AO has not established that the Assessee society is functioning as a commercial bank. The society is engaged only in lending to members, and there is no evidence that it provides banking services to the general public. In view of the above discussion, we hold that assessee society is also eligible for deduction under Section 80P(2)(a)(i) in respect of income from nominal member. Hence, the ground of appeal of the assessee is allowed.

13. The interconnected issue raised by the assessee in ground No. 4 is that the learned CIT(A) erred in confirming the disallowance of

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deduction under section 80P of the Act on the interest income earned on statutory deposit made with cooperative bank.

13.1 During the assessment proceedings, the Ld. AO observed that the assessee has earned interest income of ₹ 39,84,587.00/- from its investment in scheduled bank and Co-operative Bank. The said interest income was included in the total amount claimed as a deduction under section 80P of the Act.

13.2 The assessee during the assessment proceedings contended that the investment in Bank was made as a statutory obligation under the Karnataka Cooperative Societies Act, 1959, and hence the interest income derived from such investment qualifies for deduction as it forms part of the assessee's activity of providing credit facilities to its members.

13.3 The Assessing Officer (AO) rejected the contention of the assessee and held that the interest income earned by the assessee from Investment maintained with Bank does not arise from the business of providing credit facilities to its members. Consequently, the said income is not eligible for deduction under Section 80P(2)(a)(i) of the Act. The interest income also does not fall within the ambit of Section 80P(2)(d) of the Act, as the Investment were made with a cooperative bank and not with a cooperative society. In arriving at the above conclusion, the AO relied on the judgment of the Hon'ble Karnataka High Court in the case of PCIT vs. Totagars Co-operative Sales Society (83 taxmann.com 140), which held that interest income earned from deposits with a

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cooperative bank is not eligible for deduction under section 80P of the Act.

13.4 Based on the above findings, the AO treated the interest income amounting to ₹ 39,84,857/- only as Income from other Sources. However, the Ld. AO already disallowed the deduction u/s 80P(2)(a)(1) of Rs. 31,04,741.00 therefore, the only difference of Rs. 8,79,846 was added to the total income of the assessee as income from other sources.

14. Aggrieved assessee preferred an appeal before the Ld. CIT(A) who allowed the appeal of the assessee for statistical purpose, the relevant portion of the order of the Ld. CIT(A) is reproduced as under:

> *"5.3. Having regard to the facts of the case and placing my reliance on the recent decision of the jurisdictional ITAT in the case of Primary Agricultural Credit Cooperative Society Ltd. vs. ITO, [vide: (2024) 164 taxmann.com 327 (Bangalore - Trib.)] The AO is directed to take note of the following directions and pass an effect order accordingly.*
> *1. Where, interest income received from investments from banks was not attributable to main business of assessee of providing credit facilities to its members. then the same could not be held to be allowable as deduction under section 80P(2)(a)(i)*
> *2. Where the assessee-society claimed deduction under section 80P(2)(d) on interest income earned on its investments made with other co-operative banks, if payer bank fell under the definition of co-operative bank/ bank in light of judgment of Apex Court in case of Kerala State Co-Operative Agricultural & Rural Development Bank Ltd. v. Assessing Officer [2023] 154 taxmann.com 305/295 Taxman 675/458 ITR 384 (SC) then assessee would not be eligible to get deduction u/s. 80P(2)(d) on such interest income received from cooperative banks."*

14.1 Being aggrieved by the order of the learned CIT(A) the assessee is in appeal before us.

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15. The learned AR before us submitted that the deposits were made in the cooperative bank under the guidelines issued by the Karnataka Co-operative Society Act and therefore the interest earned thereon is eligible for deduction under section 80P(2)(a)(1) of the Act.

16. On the other hand, the learned DR vehemently supported the order of the authorities below.

17. We have heard the rival contentions of both the parties and carefully perused the materials placed on record. The facts, as undisputed are that the assessee, a cooperative society, earned interest income of ₹ 39,84,587/- on Investment in Schedule Bank and Co-Operative Bank. This interest income was claimed as eligible for deduction under section 80P of the Income Tax Act, 1961 ("the Act"). Both the AO and the learned CIT(A) rejected the claim on the grounds that the interest income did not arise from the business activity of providing credit facilities to members nor was it derived from investments made with another cooperative society.

17.1 The assessee before us contended that the cooperative banks are also cooperative society, and therefore interest income arising from deposit made with cooperative bank/society shall be eligible for deduction under section 80P(2)(d) of the Act. In our considered opinion, we do not find merit in the contention of the assessee. There has been clear distinction made between cooperative societies and cooperative bank in statute by inserting sub-section 4 to section 80P of the Act. Any income derived from deposits/investment of idle or surplus fund with cooperative bank should not qualify for deduction under the provision of

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section 80P(2)(d) of the Act. This view has been fortified by the decision of Hon'ble jurisdictional High Court of Karnataka in case of Totagars Co-operative Sales Society (supra). Further the Hon'ble Supreme Court in the case of Mavilayi Service Co-operative Bank vs. CIT reported in 123 taxmann.com 161 has observed that a cooperative society can be termed as cooperative bank falling under the mischief of subsection 4 to section 80P of the Act, if such cooperative societies is engaged in banking business i.e. lending money to member of public and for doing so hold license from RBI to carry banking business. The relevant observation of Hon'ble Supreme Court is extracted as under:

> ***39. The above material would clearly indicate that the limited object of section 80P(4) is to exclude co-operativebanks that function at par with other commercial banksi.e. which lend money to members of the public. Thus, if the Banking Regulation Act, 1949 is now to be seen, what is clear from section 3 read with section 56 is that a primary co-operativebank cannot be a primary agricultural credit society, as such co-operativebank must be engaged in the business of banking as defined by section 5(b) of the Banking Regulation Act, 1949, which means the accepting, for the purpose of lending or investment, of deposits of money from the public. Likewise, under section 22(1)(b) of the Banking Regulation Act, 1949 as applicable to co-operative societies, no co-operative society shall carry on banking business in India, unless it is a co-operativebank and holds a licence issued in that behalf by the RBI. As opposed to this, a primary agricultural credit society is a co-operative society, the primary object of which is to provide financial accommodation to its members for agricultural purposes or for purposes connected with agricultural activities.***
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> ***45.*** *To sum up, therefore, the ratio decidendi of Citizen Co-operative Society Ltd. (supra), must be given effect to. Section 80P of the IT Act, being a benevolent provision enacted by Parliament to encourage and promote the credit of the co-operative sector in general must be read liberally and reasonably, and if there is ambiguity, in favour of the assessee. A deduction that is given without any reference to any restriction or limitation cannot be restricted or limited by implication, as is sought to be done by the Revenue in the present case by adding the word "agriculture" into section 80P(2)(a)(i) when it is not there.* ***Further, section 80P(4) is to be read as a proviso, which proviso now specifically excludes co-operative banks which are co-operative societies engaged in banking business i.e. engaged in lending money to members of the public, which have a licence in this behalf from the RBI.***

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17.2 Coming to the case on hand, from the order of the authorities below, we note that the investment/deposits were made in scheduled bank or Co-Operative Bank which are hold RBI license to carry banking business. Therefore, schedule bank or Co Operative Bank in view of the ratio laid down by the Hon'ble Supreme Court falls under the mischief of provision of section 80P(4) of the Act. Accordingly, the interest arising on deposit of idle or surplus fund with schedule bank or Co-operative Bank in normal circumstances are not eligible for deduction under section 80P(2)(d) of the Act. Hence, the contention of the assessee that the cooperative banks are also cooperative society is not tenable. Hence, the impugned interest income is not eligible for deduction.

18. The next contention of the assessee is whether the deposits with Schedule Bank or Co-Operative Bank were made out of compulsory requirement under the provision of Karnataka Cooperative Society Act. Therefore, any income derived from the compulsory deposit shall be treated as income from the activity of business carried by the cooperative society i.e. providing credit facility to the member.

19. There is no ambiguity to the fact that if the assessee is liable to maintain certain reserve/deposits with the co-operative bank under the guidelines of Karnataka Co-operative Societies Act, then the interest thereon is eligible for deduction u/s 80P(2)(a)(i) of the Act. The Hon'ble Supreme Court in the case of CIT versus Karnataka State cooperative apex bank reported in 251 ITR 194 vide order dated 22 August 2001 has directed to allow deduction of the same under the provisions of section 80P(2)(a)(i) of the Act. The relevant extract of the judgement is reproduced as under:

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There is no doubt, and it is not disputed, that the assessee-co-operative bank is required to place a part of its funds with the State Bank or the Reserve Bank of India to enable it to carry on its banking business. This being so, any income derived from funds so placed arises from the business carried on by it and the assessee has not, by reason of section 80P(2)(a)(i), to pay income-tax thereon. The placement of such funds being imperative for the purposes of carrying on the banking business, the income derived therefrom would be income from the assessee's business. We are unable to take the view that found favour with the Bench that decided the case of M.P. Co-operative Bank Ltd. (supra) that only income derived from circulating or working capital would fall within section 80P(2)(a)(i). There is nothing in the phraseology of that provision which makes it applicable only to income derived from working or circulating capital.

20. However, we note that the assessee before the authorities below has not submitted supporting evidence suggesting that the deposits were made with the impugned co-operative bank in order to maintain the statutory reserve as directed under the Karnataka Co-operative Societies Act. Furthermore, we also note that the assessee did not submit the detail of quantum of amount necessary to be deposited to comply with the Karnataka Cooperative Society Act. In the identical facts and circumstances the coordinate bench of this tribunal in case of **Kalika Parameswari Co-operative Society Ltd vs. ITO** reported in 159 taxmann.com 1466 has set aside the issue to the file of the AO to compute the amount necessary to be deposited. The relevant finding of the Tribunal reads as under:

10. *As per the directions of Registrar of Karnataka Co-operative Societies which is placed at pages 52-53 of the Paper Book filed by the assessee, we find that all primary co-operative societies are to be mandatorily made to invest 25% of total deposits as liquid fund (SLR) and 3% of the total deposits as cash reserve (CRR) with the concerned Central District Co-operative Banks to run credit facilities by a primary agricultural credit co-operative society in the State of Karnataka. The CBDT Circular No.18/2015 dated 02.11.2015 has clarified that interest income from SLR/non-SLR investment by banking company and a cooperative society shall be chargeable under the head "profit and gains of business or profession". On identical factual situation, we find the Bangalore bench of the Tribunal in the case of M/s. Kachur Credit Co-operative Society Ltd., v. ITO in ITA No. 478/Bang/2023 (order dated 26.09.2023), by following earlier orders of the Tribunal, had held as follows:*

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"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 v. ITO (supra) by following the Co-ordinate Bench's order in the case of Vasavamba Co-operative Society Ltd. v. 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 v. 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."

11. *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. It is ordered accordingly.*

21. Therefore, in view of the above detailed discussion and judicial pronouncements, we in the interest of justice and fair play, are inclined to set aside the issue to the file of the AO for fresh adjudication in the

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light of above stated discussion and as per the provisions of law. Before parting, it is important to note that to the extent of interest not derived from compulsory deposits would stand disallowed after netting of the expenses/ interest expenses against such interest income in the manner provided under section 57 of the Act. Hence, the ground of appeal raised by the assessee is hereby allowed for statistical purposes.

22. The issue raised by the Assessee in ground No. 5 is that the Ld. CIT(A) erred in conforming the disallowance of the provisions made against the expenses.

23. During the assessment proceeding, the Ld. AO observed that the assessee had claimed deduction of following provision towards expenses:

S. No.	Particulars	Amount
1	Provision for Govt Interest	2,69,000.00
2	Audit Fees	60,721.00
	Total	3,29,721.00

24. The Ld. AO disallowed these expenses on the ground that they were merely provisions and not ascertained liabilities. The AO opined that provisions for expenses do not qualify as deductible expenses under the Income-tax Act, 1961. Consequently, the AO added the disallowed amount of Rs. 3,29,721/- to the total income of the assessee.

25. Aggrieved, the assessee preferred an appeal before the Ld. CIT(A), who upheld the findings of the AO and confirmed the disallowance.

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26. Being aggrieved by the order of the Ld. CIT(A), the assessee is in appeal before us.

27. The Ld. AR of the assessee submitted that the disallowance made by the AO would lead to an increase in the taxable income of the assessee. Consequently, such increased income should be eligible for deduction under section 80P(2)(a)(i) of the Income-tax Act, 1961.

28. The Ld. AR further submitted that since the assessee is engaged in activities covered under section 80P, any addition made to income would ultimately be exempt, and therefore, the disallowance of the provision would not result in any tax liability.

28.1 On the other hand, the ld. DR vehemently supported the order of the authorities below.

29. We have heard the rival submissions of both the parties and perused the materials available on record. The primary issue for consideration is whether the resultant increase in taxable income after the disallowance made by Ld. AO on account of provision for expenses of Rs. 3,29,721.00 qualifies for deduction under section 80P(2)(a)(i)..

29.1 As regards the contention of the assessee regarding the applicability of section 80P(2)(a)(i) of the Act, we find merit in the submission that the increase in total income due to disallowance should be eligible for deduction under section 80P(2)(a)(i), provided that the assessee satisfies the necessary conditions stipulated under the said provision. The resultant increase in income shall be eligible for deduction under section 80P(2)(a)(i), subject to verification by the AO

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regarding the eligibility of the assessee under the said provision. Hence, the ground of appeal of the assessee is partly allowed.

30. In the result appeal of the assessee is hereby partly allowed for statistical purposes.

Now coming to ITA No. 1943/Bang/2024 for the asst. year 2017-18.

31. At the outset, the learned counsel for the assessee before us submitted that the issues raised in the appeal on hand are identical to the issues raised in ITA No. 1927/Bang/2024 and therefore the findings given therein would be applicable for the disputes on hand. On the other hand, the ld. DR appearing on behalf of the revenue could not controvert the arguments advanced by the learned AR of the assessee. In view of the above, we hold that the findings given in IT No. 1927/Bang/2024 shall be applicable for the disputes arising in the appeal on hand. Hence, the appeal of the assessee is hereby partly allowed for statistical purposes.

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

33. In the combined result, both the appeals of the assessee are hereby partly allowed for statistical purposes.

Order pronounced in court on 28th day of January, 2025

Sd/- Sd/-

(KESHAV DUBEY) **(WASEEM AHMED)**
Judicial Member Accountant Member

Bangalore
Dated, 28th January, 2025

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/ vms /

Copy to:
1. The Applicant
2. The Respondent
3. The CIT
4. The CIT(A)
5. The DR, ITAT, Bangalore.
6. Guard file

By order

Asst. Registrar, ITAT, Bangalore

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