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

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

ITA No. 1986 & 1987/Bang/2024
Assessment Years: 2016-17 & 2017-18

SRCC Society Ltd., 1 SRCC Building, NH 13, Horti – 586 117. **PAN – AABAS 3319 N**	Vs.	The Income Tax Officer, Ward - 1 TPS, Vijayapura.
APPELLANT		RESPONDENT

Assessee by	:	Shri Lakhan G Jeju, CA
Revenue by	:	Ms. Nena Sahay, JCIT (DR)

Date of hearing	:	16.12.2024
Date of Pronouncement	:	07.03.2025

O R D E R

PER WASEEM AHMED, ACCOUNTANT MEMBER:

These are the appeals filed by the assessee against the order passed by the NFAC, Delhi dated 14/02/2024 in DIN Nos. ITBA/NFAC/S/250/2023-24/1060915659(1) and ITBA/NFAC/S/250/2023-24/1060914330(1) for the assessment year 2016-17 and 2017-18 respectively.

2. First, we take ITA No. 1987/Bang/2024 an appeal by the assessee for A.Y. 2016-17 as the lead case.

3. The assessee has raised as many as 5 grounds of appeal, however issued raised in ground nos. 1 to 5 are interconnected and pertains to the disallowance of deduction claimed under section 80P(2)(d) of the Act for Rs. 57,95,443/- only.

4. The facts in brief are that the assessee is a cooperative society and engaged in the business of providing credit facilities to its members. The assessee for the year under consideration declared gross receipt of Rs. 3,29,97,709/- and after claiming expenditure declared income of Rs. 86,44,404/- against which 100% deduction was claimed under section 80P(2)(a)(i) of the Act.

5. The AO during the assessment proceedings found that the assessee is accepting deposit and advancing loan to two class of members being (A) regular member and (B) associate/nominal member. Apart from this, the assessee has also provided loans to members of general public by making them associate members who are not falling either under class (A) or class (B) of the member. The AO further found that as per law governing the society, the assessee cannot admit the member other than regular member. The AO further found that the assessee without obtaining approval from the registrar of society is accepting deposit and advancing loan to associate members. Furthermore, the assessee is earning an income from investment in the form of a fixed deposit. Accordingly, the AO was of the view that assessee is carrying on the activity in violation of provisions of cooperative society and thereby the concept of mutuality is missing. The AO by applying the ratio of Hon'ble Supreme Court in the case of Citizen

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Co-operative Ltd vs. ACIT reported in 84 taxmann.com 114 disallowed the entire claim of the assessee under section 80P(2)(a)(i) of the Act.

6. The aggrieved assessee preferred an appeal before the learned CIT(A).

7. The assessee before the learned CIT(A) submitted that the AO primarily denied the deduction under section 80P(2)(a)(i) of the Act, asserting that the society provides credit facilities to both regular and associate members, and relied on the Supreme Court's decision in *Citizen Cooperative Society Ltd. v. ACIT* (2017). The assessee contended that the AO has misinterpreted and misapplied the ruling, as the said case involved a cooperative society accepting deposits from and granting loans to the general public, which is not the case here. The assessee claimed that it has strictly conducted its business only with its members and has neither accepted deposits nor advanced loans to the general public.

8. Further, the assessee argues that the AO erred in concluding that there was a lack of mutuality in its transactions. It was argued that under the State Cooperative Societies Act, having associate members is lawful, and there is no violation of any provisions of the Act. The assessee society claimed that it operates within the framework of cooperative laws and does not engage in activities similar to financial institutions. Since the denial of the deduction under section 80P of the Act is based on an incorrect appreciation of facts, the assessee asserted that the disallowance is unwarranted and unjustified. The assessee,

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therefore, requested the ld. CIT(A) to allow the deduction under section 80P and grant appropriate relief.

9. The learned CIT(A) carefully examined the assessment order, submissions, and relevant judicial precedents regarding the disallowance under section 80P(2)(a)(i). The ld. CIT(A) relied on the Supreme Court ruling in case of Mavilayi Service Cooperative Bank Ltd. vs. CIT reported in 123 taxmann.com 161, which clarified that if nominal members are recognized as members under the respective State Cooperative Societies Act, then profits from loans given to such members qualify for deduction. The learned CIT(A) found that the Karnataka Cooperative Societies Act includes nominal and associate members within its definition of "member," and accordingly held that the appellant is eligible for the deduction with respect to profit or gain derived from providing credit facility to members being regular or associate member.

10. However, the CIT(A) disallowed the deduction of interest income earned from surplus funds invested in banks and government securities, following the Hon'ble Supreme Court's decision in the case of Totgars Cooperative Sale Society Ltd. vs. ITO reported in 322 ITR 283, which held that such income does not constitute operational income under section 80P(2)(a) of the Act.

11. Being aggrieved by the finding of the learned CIT(A), the assessee is in appeal before us.

12. The learned AR for the assessee before us among other arguments submitted that the deposits made with the District Co-

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operative Bank Ltd, Vijayapura, are out of statutory obligation as per the Karnataka State Co-operative Societies Act, 1959, and not voluntary investments intended to earn income. As per Section 57(2) of the Karnataka State Co-operative Societies Act, 1959, co-operative societies are required to set aside 25% of their net profit every year as a reserve, which must be mandatorily invested as per section 58 of the same Act. The learned AR argued that since these deposits are not freely available for the daily business of the society and cannot be withdrawn without prior approval from the Registrar of Co-operative Societies, the interest earned on such deposits constitutes operational income rather than "Income from Other Sources." Therefore, taxing such interest income under "Income from Other Sources" is unjust and against the intent of law.

13. Without prejudice the learned AR submitted if interest accrued from impugned deposit treated as income from other sources, then the corresponding cost shall be provided against the impugned income.

14. On the contrary, the learned DR before us vehemently supported the order of the authorities below.

15. We have heard the rival contentions of both the parties and perused the materials available on record. From the preceding paragraphs, we note that the primary issue in dispute pertains to the eligibility of deduction under section 80P(2)(a)(i) of the Act in respect of interest income earned from deposits made with the District Co-operative Bank Ltd, Vijayapura. The crux of the matter is whether such interest income is to be considered as "business income" eligible for

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deduction under Section 80P(2)(a)(i) or to be classified as "Income from Other Sources" and taxed accordingly.

15.1 We note that the deposit in question was not voluntarily made by the assessee society for investment purposes but were instead mandated by the Karnataka State Co-operative Societies Act, 1959. As per section 57(2) of the said Act, every co-operative society is required to set aside at least 25% of its net profit each year as a reserve fund. Further, as per section 58 of said Act, such reserve funds must be mandatorily invested in specified institutions, including District Co-operative Banks. We find that this statutory requirement imposes a legal obligation on the assessee society to maintain such deposits, thereby restricting its ability to freely use or withdraw these funds for its business operations without prior approval from the Registrar of Co-operative Societies.

15.2 Given this statutory compulsion, we find that the interest income arising from these deposits cannot be equated with interest income derived from surplus funds voluntarily parked in banks for earning a return. Therefore, we hold that the interest income earned from such statutory deposits should be considered as operational income derived in the course of the assessee's business and consequently qualifies for deduction under section 80P(2)(a)(i) of the Act. In holding so, we also draw support and guidance from the Judgement of Hon'ble Supreme Court in case CIT versus Karnataka State cooperative apex bank reported in 251 ITR 194 where in it was held as under:

> *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*

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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.

15.3 However, we are also conscious to the fact that the detail of quantum of amount necessary to be deposited to comply with the Karnataka Cooperative Society Act is not provided by the assessee neither looked into by the lower authorities. 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:*

"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

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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.*

15.4 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 with direction to compute the required quantum of amount needs to be deposited as per statutory requirement and allow the claim of the deduction under section 80P(2)(a)(i) of the Act of corresponding interest income.

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15.5 Furthermore, without prejudice to the above finding, we are also inclined to consider the alternative plea raised by the assessee. In the event that the AO found that the any amount of investment over and above the required statutory limit and classify the interest income from such deposits as "Income from Other Sources," then it is imperative that the corresponding cost incurred in earning such income must be deducted while computing taxable income. It is a well-established principle of taxation that only net income should be brought to tax, and any expenditure directly attributable to the earning of such income should be allowed as a deduction. Therefore, we direct the AO to grant a proportionate deduction of the corresponding cost, if any, while assessing the interest income under the head "Income from Other Sources."

15.6 In light of the above reasoning, we hold that the assessee is entitled to deduction under section 80P(2)(a)(i) of the Act on the interest income earned from deposits made in compliance with statutory requirements. The AO is directed to re-examine the taxability of such interest income in accordance with this finding, as per law and grant appropriate relief to the assessee. Hence, the grounds of appeal of the assessee are allowed for statistical purposes.

16. In the result appeal of the assessee is allowed for statistical purposes.

Coming to ITA No. 1986/Bang/2024 appeal by the assessee for A.Y. 2017-18

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17. At the outset, we note that the issues raised by the assessee in the captioned appeal for the AY 2017-18 are identical to the issue raised by the assessee in ITA No. 1987/Bang/2024 for the assessment year 2016-17. Therefore, the findings given in ITA No. 1987/Bang/2024 shall also be applicable for the assessment years 2017-18. The appeal of the assessee for the A.Y. 2016-17 has been decided by us vide paragraph No. 15 of this order in favour of the assessee for statistical purposes. The learned AR and the DR also agreed that whatever will be the findings for the assessment year 2016-17 shall also be applied for the assessment years 2017-18. Hence, the ground of appeal filed by the assessee is hereby allowed for statistical purposes.

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

19. In the combined result, both the appeals of the assessee are allowed for statistical purposes.

Order pronounced in court on 7th day of March, 2025

Sd/-	Sd/-
(KESHAV DUBEY)	**(WASEEM AHMED)**
Judicial Member	Accountant Member

Bangalore
Dated, 7th March, 2025

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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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