

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

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

ITA No.459 & 460/Bang/2025
Assessment Year: 2017-18 & 2018-19

Sullia Primary Co-operative Agricultural & Rural Development Bank, Main Road, Near KSRTC Bus Sand, Sullia – 574 239.	Vs.	The Income Tax Officer, Ward – 1, Puttur.
PAN – AAOAS 8826 M		
APPELLANT		RESPONDENT

Assessee by	:	Shri Shiv Rao, CA
Revenue by	:	Shri Subramanian S, JCIT

Date of hearing	:	26.06.2025
Date of Pronouncement	:	16.09.2025

ORDER

PER WASEEM AHMED, ACCOUNTANT MEMBER:

Both these i appeals are filed by the assessee against the order passed by the NFAC, Delhi vide order both dated 08/01/2025 in DIN No. ITBA/NFAC/S/250/2024-25/1071997861(1) and ITBA/NFAC/S/250/2024-25/1071997924(1) for the assessment years 2017-18 and 2018-19.

2. The assessee has raised extensive grounds of appeal running into multiple pages which are numbered as 1 to 10 of the memo of appeal.

3. The issue raised in ground Nos. 1 to 3 pertains to the disallowances of deduction claimed under section 80P of the Act on account of alleged violation of concept of mutuality.

4. The relevant facts are that the assessee is primary agricultural cooperative society registered under Karnataka Cooperative Societies Act. For the year under consideration the assessee society declared total income at Rs. 2,54,500/- after claiming deduction of Rs. 1,27,17,965/- under the provision of section 80P of the Act.

5. The AO during the assessment proceeding found that as per the bylaws of the assessee, there were three types of members viz (i) A Class Members, (ii) B Class Members and (iii) C Class Members.

"A Class Member" represent regular members who has subscribed shares of Rs. 500 each. The regular members have all the rights being voting rights, share in profit, participate in administration and right to access the audited financial statements.

"B Class Member" represent nominal or associate members who become member by subscribing shares of Rs. 20/- each. These members do not have any rights as enjoyed by the regular members. They can only make deposit and receive loan.

"C Class Member" member represents shares subscribed by the State Government for Rs. 1000/ each share.

5.1 During the year, there were 3159 members of "A Class" and 4920 members of "B Class" whereas zero member of "C Class". Further, the AO observed that during the year A class members have made deposit/investment of Rs. 4,82,97,320/- only whereas B class members

have made deposit/investment of 14,48,91,961/- only. Both class of members (to A and B class members) have been paid interest of Rs. 28,71,695/- and Rs. 76,88,048/- respectively by the assessee. Likewise, the assessee during the year received interest of Rs. 24,68,69773/- and Rs. 76,556/- from A and B Class members respectively.

5.2 Based on above the AO alleged that the assessee society done majority of its business with nominal/associate members who are not participating the in the share of profit and voting rights. These are not the members in true sense but only contributing to the revenue generated by the assessee society without participating in the profit. Hence the essence of mutuality is missing on which premises the cooperative society work. The AO alleged that the facts involved in present assessee is covered by the decision of Hon'ble Supreme Court in the case of Citizen Cooperative Society Ltd in civil appeal No. 10245 of 2017.

6. The assessee in reply submitted that the case of the Citizen Cooperative Society is different from the facts of the assessee. The Citizen Cooperative Society Ltd was working as bank and dealt with members as well as general public and having presence in multiple state. Further, the Citizen Cooperative was registered under different Act of different states in which admission of nominal or associate member was not allowed.

7. However, the AO dismissed the argument of the assessee. The AO held that the assessee society has three categories of members – A, B, and C. While A-class members are regular members with voting rights

and dividend entitlement, the B and C category members, mainly associated or nominal members, have no such rights. These associated/nominal members can make deposits and take loans, but they do not have voting rights and are not entitled to participate in the surplus or receive dividends.

7.1 The AO noted that this arrangement goes against the principle of mutuality, which requires equality of rights and a common identity between contributors and participators. Relying on judicial precedents such as *CIT vs. Kumbakonam Mutual Benefit Fund Ltd.* reported in 53 ITR 241 and *Citizen Co-operative Society Ltd.(supra)*, the AO emphasized that for claiming exemption under section 80P of the Act, there must be a complete identity between members contributing and members enjoying the benefits. In this case, nominal/associated members only contributed funds but were deprived of participation in profits, administration, other rights, which breaks the concept of mutuality.

7.2 The AO further highlighted that the denial of voting rights and sharing of profits to certain categories of members shows discrimination among members, and such a structure cannot be regarded as a true co-operative society functioning on mutual principles. Since the assessee society was found to be conducting transactions with nominal members akin to finance business rather than mutual activity, the AO concluded that the deduction under section 80P(2) of the Act is not allowable. Accordingly, the entire claim of deduction was disallowed.

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

9. Before the Learned CIT(A), the assessee submitted that the main object is to provide credit facilities to its members. The income earned by way of banking business of providing credit facility to the members are eligible for deduction under section 80P of the Act.

10. It is submitted that section 80P is a benevolent provision intended by Parliament to promote the growth of the co-operative sector. The Hon'ble Supreme Court in *Mavilayi Service Co-operative Bank Ltd. v. CIT* (2021) 123 taxmann.com 161 (SC) has clearly held that the deduction under section 80P must be read liberally and in favour of the assessee. The Hon'ble Court further observed that even if loans are given to nominal members, it does not affect the eligibility to claim deduction. However, the learned CIT(A) confirmed the finding of the AO by observing as under:

5. I have considered the facts of the case, assessment order and submission made by the appellant. The appellant has raised 8 grounds in the present appeal. Ground no.1, 2, 4, 5 & 6 are related grounds where appellant has challenged disallowance of deduction u/s.80P(2)(a)(i) of the IT Act of Rs.1,27,17,965/-. The said deduction includes interest income from its investments in scheduled banks and co-operative banks other than co-operative societies at Rs.23,26,564/- which AO has considered same under the head "Income from Other Sources" and denied deduction U/s. 80P. This action of the AO was challenged by appellant by his ground of appeal no. 3. The ground no.8 of the appeal is general in nature. Since ground nos.1, 2, 4 to 6 are related grounds and concerned with disallowance of deduction U/s.80P, same are adjudicated as below:

5.1 *The AO in the assessment order observed that principle object of the society as stipulated in by-law as approved by Registrar of Co-operative Societies is to accept deposits from members and providing credit facilities and financial assistance to its members. However, the Society has 3 class members viz. A-Class member, B-Class member, C-Class member and having different rights and duties as members under different category. Nominal Class of members (B-Class) are also admitted and contributed to the society by way of subscribing shares of the society and not allowed to entitle for profits of the*

society. AO further observed that deposits/ investments received from Category B members is much more than deposits / investments received from regular members and which clearly indicates that society is dealing with nominal members in a large scale than regular members. The nominal members are not allowed to vote and they are not entitled for sharing the profits of the society. Here the concept of mutuality is missing and society is violated the principles of mutuality. He further relied upon Hon'ble Apex Court judgement in the case of Citizen Co-op. Society Ltd 397 ITR 1 (2017). The AO has also cited Apex Court judgement in the case of CIT vs. Kumbakonam Mutual Benefit Fund Ltd 53 ITR 241 (1964) where Hon'ble Court has held that the predominant and fundamental principle underline the existence of co-operative societies is the issue of mutuality whereby there is complete identity between member contributor and the participators who have pulled the resources with the aim of sharing the profits and losses. Considering the above principles, the AO held that appellant cannot be termed as a mutual concern and the principles of mutuality cannot be applied. The transactions with the associate/ nominal members result in certain income / advantages which are used by the society or rather applied to the benefit of the regular members. Under the circumstances, the entire deduction claimed by the appellant society under 80P(2) of the Act was disallowed by the AO. During the appellate proceedings, appellant has submitted that benefit of section 80P(2)(a)(i) cannot be denied for the reason that loan has been provided to non-members. Income attributed to the loan given to the non-members only can be disallowed. If there is no restriction for giving loan to non-members, the deduction u/s.80P cannot be denied. From the submission made by the appellant, it is clear that it was doing business with non-members and nominal members and however, it has not differentiated how much income it earned from the Class-A members (permanent members) and Class-B members (nominal members). Without differentiating the income earned by the appellant category-wise it is difficult to substantiate its claim. However, AO in his order clearly brought out how principles of mutuality were not followed in the case of the appellant and thereby appellant society violated the concept of mutuality. Even though appellant society was registered as a Co-operative Society with the Registrar of Co-op. Societies it is not fulfilling the basic objects and by-laws for which it was approved. In view of that disallowance of deduction U/s. 80P(2)(a) made by the AO is hereby sustained. Ground nos. 1, 2, 4 to 6 of the appellant are dismissed.

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

12. The learned AR before us submitted that the AO has wrongly held that the assessee society is not entitled to deduction under section 80P(2)(a)(i) of the Act. The AO relied on the judgment of the Hon'ble Supreme Court in the case of *Citizen Co-operative Society Ltd. (2017)*

397 ITR 1 (SC) to say that dealings with nominal members violate the principle of mutuality. However, this reliance is misplaced because the later judgment of the Hon'ble Supreme Court in the case of *Mavilayi Service Co-operative Bank Ltd. v. CIT* (2021) 431 ITR 1 (SC) has clearly distinguished and limited the application of the earlier judgment. The Hon'ble Court has categorically held that nominal members are also to be treated as "members" within the meaning of the State Co-operative Societies Act, and therefore, dealing with such nominal members does not make the assessee ineligible for deduction under section 80P(2)(a)(i) of the Act.

12.1 The learned AR further submitted that as per the provisions of the Karnataka Co-operative Societies Registration Act, 1959, nominal members are recognized as members. They may not enjoy all privileges such as voting or profit-sharing, but they are still members under the law. Hence, transactions entered into by the assessee society with such nominal members cannot be treated as transactions with "non-members" or the general public. Therefore, the AO's observation that the assessee violated the mutuality is not correct.

12.2 The Id. AR argued that the very object of section 80P of the Act is to encourage and promote the co-operative movement. The provision is a beneficial one and has to be read liberally in favour of the assessee, as repeatedly held by the Hon'ble Supreme Court. If Parliament wanted to restrict the deduction, it would have done so specifically, as seen in section 80P(4) of the Act, which excludes only co-operative banks from its ambit. The assessee is not a co-operative bank but a primary agricultural credit co-operative society. Its main activity is to provide

credit to members, including nominal members, and therefore the income from such activities is fully deductible under section 80P(2)(a)(i) of the Act.

13. On the contrary, the learned DR vehemently supported the findings of lower authorities.

14. We have heard the rival contentions of both the parties and perused the materials available on records. The dispute before us is whether the assessee society is entitled to deduction under section 80P(2)(a)(i) of the Act in respect of income earned from providing credit facilities to its members, where such members include both regular members and nominal/associate members.

14.1 It is not in dispute that the assessee is a Primary Agricultural Co-operative Credit Society registered under the Karnataka Co-operative Societies Act. The AO and the Id. CIT(A) have proceeded to deny the benefit of section 80P(2)(a)(i) of the Act mainly on the ground that a large volume of transactions were with nominal members (B-Class), who do not enjoy the same rights as A-Class members. According to the revenue, this destroys the principle of mutuality and therefore the entire deduction cannot be allowed.

14.2 We note that the reliance placed by the lower authorities on the decision of the Hon'ble Supreme Court in *Citizen Co-operative Society Ltd. v. ACIT* (397 ITR 1) is misplaced in the facts of the present case. The later judgment of the Hon'ble Supreme Court in *Mavilayi Service Co-operative Bank Ltd. v. CIT* (431 ITR 1) has clarified that the question of

eligibility under section 80P(2)(a)(i) of the Act has to be examined in the light of the respective State Co-operative Societies Act. The Hon'ble Court has also held that the decision in *Citizen Co-operative Society Ltd.* was rendered in the context of a different statute where admission of nominal members was not permissible.

14.3 Under the Karnataka Co-operative Societies Act, 1959, as amended, the law specifically recognizes the admission of nominal and associate members. Section 18 of the said Act lays down that such members, though subject to limitations, are also to be treated as "members" of the society. They may not have voting rights or profit-sharing rights, but their admission is valid under the statute. Once the statute permits admission of such members, transactions with them cannot be equated to transactions with non-members or the general public. In our view, therefore, the presence of nominal or associate members by itself cannot lead to the denial of the entire claim under section 80P(2)(a)(i) of the Act. Hence the ground of the appeal of the assessee is hereby allowed.

15. The next issue raised by the assessee is that the learned CIT(A) erred in confirming the disallowance of deduction u/s 80P of the Act on account of interest income from deposits.

16. The relevant facts are that the AO found that the assessee during the year has earned interest income of Rs. 23,26,564/- on account of deposit made with Scheduled Bank and Cooperative Bank other than cooperative societies. The AO observed that that though the assessee is under obligation to make compulsory deposit or investment as per the

provisions of Karnataka Cooperative Societies Act, but the resultant income cannot be held as income derived from business of providing credit facility to the member. Hence, the same is not eligible for deduction under section 80P(2)(a)(i) of the Act. The impugned interest income was also not eligible for deduction under section 80P(2)(d) of the Act as the same is not from deposits or investment with cooperative society. The cooperative banks are not the cooperative society for the purpose of deduction under section 80(2)(d) of the Act. Hence, the AO disallowed the amount of Rs. 23,26,564/- however, no separate addition was made to the total income for this amount for reason that entire claim under section 80P was disallowed and added to the total income on account of concept of mutuality.

17. The aggrieved assessee preferred an appeal before the learned CIT(A) who confirmed the finding of the AO.

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

19. The learned AR before us submitted except for interest income of Rs. 5692/- and Rs. 54,049/- being earned from deposit with Bank of Broda and The South Canara District Central Cooperative Bank respectively, all the remaining interest income was earned from deposit or investment with cooperative society. Therefore, such incomes are eligible for deduction under section 80P(2)(d) of the Act.

20. The learned AR further argued that the deposit or investment was made out of compulsion of SLR requirement as mandated under

Karnataka Cooperative Societies Act. Therefore, income derived from such compulsory investment or deposit shall be eligible for deduction under section 80P(2)(a)(i) of the Act.

21. On the contrary, the learned DR vehemently supported the finding of the lower authorities.

22. We have heard rival contentions of both parties and perused the materials available on record. The issue is whether the assessee's interest of ₹23,26,564/- earned from deposits is eligible for deduction under section 80P(2)(a)(i) or 80P(2)(d) of the Act. The AO held that such interest is not income derived from the business of providing credit to members and that section 80P(2)(d) is also not available because the money was placed with banks and not with co-operative societies. The Id. CIT(A) affirmed this view. The assessee contends that, except interest of ₹5,692 from Bank of Baroda and ₹54,049 from South Canara District Central Co-operative Bank, the balance interest was received from investments with co-operative societies and must be allowed under section 80P(2)(d) of the Act. The assessee also submits that the deposits were mandated by the Karnataka Co-operative law as SLR, and therefore the interest is attributable to its business and eligible under section 80P(2)(a)(i) of the Act.

22.1 On law, section 80P(2)(d) allows deduction for interest derived from investments with "any other co-operative society." Thus, if the payer is a co-operative society under the relevant co-operative law, the recipient society is entitled to deduction on such interest. Interest from a scheduled bank like Bank of Baroda and cooperative bank like South

Canara District Central Co-operative Bank does not fall under section 80P(2)(d) of the Act. Further, under section 80P(2)(a)(i), the touchstone is whether there is a direct and proximate nexus between the interest and the assessee's business of providing credit to its members. Mere parking of surplus funds ordinarily does not satisfy this test. However, if the deposit is a statutory compulsion (SLR), integral to carrying on the business of providing credit, and the funds are business funds kept as a condition of that business, the nexus may be established.

22.2 Applying the above, we hold as under. First, interest received from Bank of Baroda and South Canara District Central Co-operative Bank is not eligible under section 80P(2)(d) of the Act but the cost of funds should be seen while denying the benefit of deduction under section 80P(2)(a)(i) of the Act. Second, for the remaining interest, the sums which the assessee claims to have received from investments with co-operative societies, the AO shall verify the payers and, on confirmation that the payers are co-operative societies, allow deduction under section 80P(2)(d) of the Act. Third, as regards the alternative plea under section 80P(2)(a)(i), the AO shall examine the statutory SLR requirement under the Karnataka Co-operative law, the nature of the funds, and the terms of deposit. If the deposits are shown to be a statutory pre-condition integral to the assessee's lending business and not mere surplus deployment, the interest therefrom shall be treated as attributable to that business and allowed under section 80P(2)(a)(i) of the Act. The same income shall not be allowed twice; if it is eligible under section 80P(2)(d) of the Act, no duplication shall be made under section 80P(2)(a)(i) of the Act.

23. In the result, the blanket disallowance sustained by the Id. CIT(A) is unsustainable. The matter is restored to the AO for the limited verification and allowance as directed above, after granting due opportunity to the assessee. The ground is allowed for statistical purposes.

24. The last issue raised by the assessee relates to the disallowance of provision for Bank Golden Jubilee expenses amounting to ₹1,00,000/-. The assessee, a co-operative society, in its profit and loss account created a provision of ₹1,00,000/- towards expenditure on the celebration of its Golden Jubilee. The Assessing Officer, during the course of assessment proceedings, held that the said provision represented a contingent liability which may or may not arise in future, and therefore not an ascertained liability allowable as deduction under section 37(1) of the Act. The Assessing Officer disallowed the claim.

25. In appeal, the assessee did not raise any specific ground before the learned CIT(A) against the said disallowance. Consequently, the learned CIT(A) sustained the action of the Assessing Officer.

26. Being aggrieved by the order of the AO, the assessee is in appeal before us.

27. Before us, the learned Authorised Representative (AR) submitted that though no ground was taken before the first appellate authority, the assessee is entitled to raise such a plea before the Tribunal. Reliance was placed on the decision of the Hon'ble Supreme Court in *National Thermal Power Co. Ltd. v. CIT* (229 ITR 383) for the proposition that the

Tribunal has plenary powers under section 254(1) of the Act to consider legal issues arising from facts already on record.

27.1 On merits, it was contended that the provision for the expenditure for Golden Jubilee celebration is wholly and exclusively for the purposes of business. It was submitted that such expenditure builds goodwill of the society, strengthens relationship with members, depositors and employees, and enhances the image and standing of the bank in the business community. Hence, it is an allowable business expenditure u/s 37(1) of the Act.

27.2 The learned Departmental Representative (DR), however, supported the orders of the AO and argued that the provision was unascertained and hence rightly disallowed.

28. We have heard the rival submissions of both the parties and perused the records. At the threshold, though the assessee had not pressed this ground before the learned CIT(A), we find that the issue is a pure question of law arising from the facts on record. The Hon'ble Supreme Court in *NTPC* (supra) has held that the Tribunal has jurisdiction to entertain such legal pleas. We therefore admit the ground. On merit of the case, we note that since the assessee is not pressing the allowability of the provision itself, we refrain from going into the merits of the disallowance. At the same time, we hold that the Assessing Officer shall examine the computation and grant consequential enhanced deduction under section 80P of the Act, in accordance with law, while giving effect to this order. Accordingly, this ground is treated as partly allowed, in terms indicated above.

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

Coming to ITA 460/Bang/2025, an appeal by the assessee for the AY 2018-19

30. The issue raised pertains to the disallowances of deduction claimed under section 80P of the Act on account of alleged violation of concept of mutuality.

31. At the outset, we note that the issue raised by the assessee in the impugned ground of appeal is identical to the issue raised in ITA No. 459/Bang/2025 for the assessment year 2017-18 which has been decided in favour of the assessee vide paragraph No.14 to 14.3 of this order. Both the learned AR and the DR at the time of hearing also agreed that whatever will be the finding in ITA No. 459/Bang/2025 shall also be applied in the year under consideration. Respectfully following the same, the issue raised by the assessee in the appeal on hand is also allowed in favour of the assessee.

32. In the result the appeal filed by the assessee is allowed.

33. In the combined result, ITA No. 459/Bang/2025 is partly allowed whereas ITA No. 460/Bang/2025 is allowed.

Order pronounced in court on 16th day of September, 2025

Sd/-

(KESHAV DUBEY)

Judicial Member

Bangalore

Dated, 16th September, 2025

Sd/-

(WASEEM AHMED)

Accountant Member

/ 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