

**IN THE INCOME TAX APPELLATE TRIBUNAL**  
**'C' BENCH : BANGALORE**  
**BEFORE SHRI CHANDRA POOJARI, ACCOUNTANT MEMBER**  
**AND**  
**SMT. BEENA PILLAI, JUDICIAL MEMBER**

<b>ITA No.1257 &amp; 1258/Bang/2019</b>
<b>Assessment Year : 2015-16</b>

M/s Potters Cottage Industiral Co-operative Society Ltd., 02, Kulala Sahakara Bhavana, Puttur-574 201.	<b>Vs.</b>	The Income-Tax Officer, Ward-1, Puttur.
<b>PAN - AAAAP 1215 B</b>		
<b>APPELLANT</b>		<b>RESPONDENT</b>

Assessee by	:	Shri V Srinivasan, Advocate
Revenue by	:	Smt. H Kabila, Addl.CIT

Date of Hearing	:	26-08-2021
Date of Pronouncement	:	30-08-2021

**ORDER**

**PER BEENA PILLAI, JUDICIAL MEMBER**

Present appeals are filed by the assessee against the common order dated 25/03/2019 passed by the Ld.CIT(A) Mangaluru for assessment year 2015-16 and 2016-17 on the following grounds. At the outset the Ld.Counsel submitted that issues raised by assessee in both the appeals are common on identical facts. Accordingly we are reproducing the grounds raised by assessee for assessment year 2015-16 that is as under:

*“1. The orders of the authorities below in so far as they are against the appellant are opposed to law, equity, weight of evidence, probabilities, facts and circumstances of the case.*

*2. The learned CIT[A] is not justified in upholding the denial of deduction claimed u/s.80P[2][a][i] of the Act amounting to Rs.51,36,8881- in respect of the profits earned by the appellant from the business of providing credit facilities to its members under the facts and in the circumstances of the appellant's case.*

*3. The learned CIT[A] erred in holding that the business of providing credit facilities to the members carried on by the appellant cannot be regarded as a business carried on by a co-operative society complying with the principles of mutuality since the appellant had admitted nominal members, who could neither vote nor were entitled to a share in the of its as per the bye-laws of the appellant and hence, the appellant was not entitled to deduction u/s. 80P[2][a][i] of the Act having regard to the rationale behind the judgment of the Hon'ble Supreme Court in the case of Citizens Co-operative Society reported in 397 ITR 1 [SC] under the facts and in the circumstances of the appellant's case.*

*4. The learned CIT[A] ought to have appreciated that the appellant cooperative society had no doubt admitted nominal members, which was permissible under the Karnataka Co-operatives Societies Act, 1959 and that there was no violation of any of the provisions of the Karnataka Co-operative Societies Act under which the appellant was constituted and therefore, the judgment of the Hon'ble Supreme Court relied upon in the case of Citizens Co-operative Society reported in 397 ITR 1 was distinguishable and wholly inapplicable to the facts of the appellant's case.*

*5. Without prejudice to the above, the Learned CIT[A] ought to have appreciated the alternate claim made by the appellant for allowance of deduction u/s. 80P of the Act with reference to the extent of income derived from advances given to members apart from nominal members, which was exempt under the principles of mutuality as held by the Hon'ble Bombay High Court in the case of M/s. QUEPEM URBAN CO-OPERATIVE CREDIT SOCIETY LTD in ITA No. 22 to 24 of 2015 dated 17/04/2015 under the facts and in the circumstances of the appellant's case.*

*6. The learned CIT[A] ought not to have held that the income earned by the appellant from investments made in Commercial Banks, South Canara District Central Co Operative Bank, Co-operative Societies and Income-tax Department to the extent of Rs. 32,37,160/- was liable for*

*assessment as income from business and not under the head "Other Sources" under the facts and in the circumstances of the appellant's case.*

*7. The learned CIT[A] ought to have appreciated that the appellant had earned the interest income from investments statutorily required to be maintained under the Karnataka Co-operative Societies Act from out of the profits besides 25% of the total deposits as SLR with co-operative banks and 3% of the total deposits towards CRR and thus, the income earned therefrom ought to have been assessed as part of the business of the providing credit facilities to its members and not under the head 'Other Sources' under the facts and in the circumstances of the appellant's case.*

*8. Without prejudice to the above, the learned CIT[A] ought to have appreciated that the cost of funds ought to have been allowed u/s. 57[iii] of the Act while assessing the interest income under the head "Other Sources" under the facts and in the circumstances of the appellant's case.*

*9. Without prejudice to the right to seek waiver with the Hon'ble CCIT/DG, the appellant denies itself liable to be charged to interest u/s 234-A and 234-B of the Act, which under the facts and in the circumstances of the appellant's case deserves to be cancelled.*

*10. For the above and other grounds that may be urged at the time of hearing of the appeal, your appellant humbly prays that the appeal may be allowed and Justice rendered and the appellant may be awarded costs in prosecuting the appeal and also order for the refund of the institution fees as part of the costs."*

**Brief facts of the case are as under:**

2. The Assessee is a co-operative society engaged in the business of acceptance of deposits from members, lending loans, providing banking facilities in rural village. Ld.AO observed that the purpose of creation of the societies is overall upliftment of Potters and Potter industry within the jurisdiction of the society. For years under consideration assessee filed its return of income after claiming deduction under section 80P of the Act. The return was selected for scrutiny under Cass and notice

under section 143(2) was issued to assessee. In response to the statutory notices, representative of assessee appeared before the Ld.AO and filed requisite details as called for.

2.1 The Ld.AO from the details filed observed that:

- a) assessee has earned interest on investment in South Canara district co-operative bank
- b) assessee has claimed deduction under section 80P(2)(a) of the act in respect of amount of profit attributable to the activity of providing credit facilities to its members.

2.2 In the instant case, it was noticed by the Ld.AO during assessment proceedings, that the assessee society was earning income not only from the members but majority of the income from the nominal/ Associate members. Taking into cognizance the ratio of decision of *Hon'ble Supreme Court*, in the case of *Citizen Co-op Society Ltd, Hyderabad v. ACIT, C-9(1), Hyderabad in Civil Appeal No.10245 of 2017 dated 8.08.2017* the Ld.AO denied deduction claimed u/s.80P by holding that the assessee provided credit facilities to three categories of members viz., i) Regular member ii) Associate members and iii) Nominal members. Hence, Ld.AO disallowed the deduction claimed u/s.80P(2)(a)(i) of the Act.

2.3 The Ld.AO was of the view that principle of mutuality were violated by assessee and therefore denied the deduction in view of the decision of *Hon'ble Supreme Court in case of Citizen co-*

*operative society Ltd.* in *Civil appeal No. 10245/2017* dated 08.08.2017, on following grounds:

i) interest/dividend income was held to be income from other sources and excluded from the deduction under section 80P(2)(a)(i). For the deduction under section 80P(2)(d) was also denied relying on the decision of *Hon'ble Karnataka High Court* in case of *M/s Totgars Co-operative so sale society Ltd.* by order dated 16/06/2070.

ii) The principles of majority were violated relying on the decision of *Hon'ble Supreme Court* in case of *M/s citizen co-operative society Ltd., Hyderabad dated 08/09/2017.*

2.4 Aggrieved by the order of Ld.AO, assessee preferred appeal before the Ld. CIT(A).

2.5 He came to the conclusion that as per the decision of *Hon'ble Supreme Court* in the case of *Citizens Co-op Society (Supra)*, if the principle of mutuality is not satisfied, then the assessee is not entitled to deduction u/s 80P(2)(a)(i) of the Act.

In respect of members, the Ld.CIT(A) observed that the assessee admitted excess nominal/associate members which is more than 15% of the total members when compared to regular members which is in violation of Karnataka Co-operative Society Act, 1959. In view of the violation of the Karnataka Co-operative Society Act, the Ld.CIT(A) observed that the society is not eligible for deduction u/s 80P and as such ratio of the decision of *Hon'ble Supreme Court* decision in the case of *Citizen Co-op Society Ltd,*

*Hyderabad v. ACIT, C-9(1), Hyderabad in Civil Appeal No.10245 of 2017 dated 8.08.2017* is applicable to the facts of the assessee society.

2.6 The Ld.CIT(A) also held that, in the assessee's case, mutuality principles have failed as substantial business is being carried out with the general public or nominal members and also in view of the assessee being registered as Souharda Co-operative Society and not as Co-operative Society and taking into account the byelaws and the nature of business carried out by the assessee, the society is *not eligible* for deduction u/s 80P of the Income tax Act, 1961.

2.7 The Ld.CIT(A) thus upheld the order of Ld.AO.

2.8 Aggrieved by the order of Ld.CIT(A) assessee is in appeal before us now.

3. We have considered the rival submissions of both sides in the light of records placed before us.

3.1 The issue that arises for consideration is:

- (i) whether the authorities below were justified in denying the claim of the assessee for reduction u/s 80P(2)(a)(i) of the Act. (Grounds 2-5)
- (ii) whether, interest income earned by assessee is eligible for deduction u/s 80P(2)(d) of the Act, whereas the deduction is one claimed u/s 80P(2)(a)(i) of the Act. (Grounds 6-7)

4. **Ground No. 1 & 10** are general in nature and therefore do not require any adjudication.

**Grounds 2-5:**

5. In respect of associate/nominal members, *Hon'ble Supreme Court* in the case of *Mavilayi Service Cooperative Bank Ltd. v. CIT (2021) 123 taxmann.com 161 (SC)* has held that the expression "Members" is not defined in the Income-tax Act. Hence, it is necessary to construe the expression "Members" in section 80P(2)(a)(i) of the Act in the light of definition of that expression as contained in the concerned co-operative societies Act. In view of this, the facts are to be examined in the light of principles laid down by the *Hon'ble Supreme Court* in *Mavilayi Service Cooperative Bank Ltd. (supra)*. Accordingly, we remit this issue of deduction u/s. 80P(2)(a)(i) of the Act to the file of Assessing Officer to examine the same afresh in the light of the above judgment.

**Accordingly grounds 2-5 stands allowed for statistical purposes.**

6. **Ground 6-7** is in respect of granting of deduction u/s 80P(2)(a)(i) set on interest from investments made in commercial banks, South Canara district co-operative banks, co-operative societies.

6.1 We note that the Ld.AO denied deduction under section 80P(2)(d) of the Act, as well in respect of interest income received by assessee from deposits kept with banks for the years under consideration. The Ld.AO assessed the interest income received from bank deposits under the head income from other sources.

6.2 The Ld.Counsel placed reliance on the decision of *Hon'ble Karnataka High Court* in keep case of *Totgars co-operative sale society Ltd. vs ITO* reported in (2015) 58 Taxmann.com 35.

6.3 We have perused plethora of decisions on this issue by *Hon'ble Karnataka High Court* and the ratio laid down by *Hon'ble Supreme Court*. *Hon'ble Supreme Court* in the case of the *Totgars Co-operative Sale Society Ltd. Vs. ITO* reported in

322 ITR 283 held that, Income from utilisation of surplus funds was taxable under the head income from other sources, and therefore not eligible for deduction u/s 80P.

6.4 The Co-ordinate Bench of this Tribunal in the case of M/s Jyothi Pattin Souhard Sahakari Niyamit in ITA No.650/Bang/2020 for asst. year 2015-16 by order dated 13/8/2021 held as under:-

*"In the case of **PRINCIPAL COMMISSIONER OF INCOME TAX AND ANOTHER vs. TOTAGARS CO-OPERATIVE SALE SOCIETY 392 ITR 0074 (Karn)** in the context of deduction u/s.80P(2)(d) of the Act, it was held that Sec.80P(2)(d) of the Act allows deduction 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. The Hon'ble Court held that that the aforesaid Supreme Court's decision in the case of Totgars (supra), was not applicable to deduction u/s.80P(2)(d) of the Act, because the said decision was rendered with regard to deduction under Section 80P(2)(a)(i) of the Act and not under Section 80P(2)(d) of the Act.*

9. However, the Hon'ble Karnataka High Court in the case of **PRINCIPAL COMMISSIONER OF INCOME TAX AND ANOTHER vs. TOTAGARS CO-OPERATIVE SALE SOCIETY 395 ITR 0611 (Karn)** took a different view and held that interest income earned on deposits whether with any other bank will be in the nature of income from other sources and not income from business and therefore the deduction u/s.80P(2)(d) of the Act cannot be allowed to the Assessee. The Hon'ble Court followed decision of Hon'ble Gujarat High Court in the case of SBI Vs. CIT 389 ITR 578(Guj.) in which the Hon'ble Gujarat High Court dissented from the view taken by the Hon'ble Karnataka High Court in the case of Tumkur Merchants case (supra) The Hon'ble Court had to deal with the following substantial question of law:

*"(I) Whether the assessee, Totagar Co-operative Sale Society, Sirsi, is entitled to 100% deduction under Section 80P(2)(d) of the Income Tax Act, 1961 (for short 'the Act') in respect of whole of its income by way of interest earned by it during the relevant Assessment Years from 2007-2008 to 2011-2012 on the deposits or investments made by it during these years with a Co-operative Bank, M/s. Kanara District Central Co-operative Bank Limited?*

*(II) Whether the Supreme Court decision in the case of the present respondent assessee, Totgar Co-operative Sale Society Limited itself rendered on 08th February 2010, in Totgar's Co-operative Sale Society Limited v. Income Tax Officer, reported in (2010) 322 ITR 283 SC : (2010) 3 SCC 223 for the preceding years, namely Assessment Years 1991-1992 to 1999-2000 (except Assessment Year 1995-1996) holding that such interest income earned by the assessee was taxable under the head 'Income from Other Sources' under Section 56 of the Act and was not 100% deductible from the Gross Total Income under Section 80P(2)(a)(i) of the Act, is not applicable to the present Assessment Years 2007-2008 to 2011-2012 involved in the present appeals and therefore, whether the Income Tax Appellate Tribunal as well as CIT*

(Appeals) were justified in holding that such interest income was 100% deductible under Section 80P(2)(d) of the Act?"

10. The Hon'ble Court held that such interest income is not income from business but was income chargeable to tax under the head income from other sources and therefore there was no question of allowing deduction u/s.80P(2)(d) of the Act. The following points can be culled out from the aforesaid decision:

1. What Section 80P(2)(d) of the Act, which was though not specifically argued and canvassed before the Hon'ble Supreme Court, envisages is that such interest or dividend earned by an assessee co-operative society should be out of the investments with any other co-operative society. The words 'Co-operative Banks' are missing in clause (d) of subsection (2) of Section 80P of the Act. Even though a co-operative bank may have the corporate body or skeleton of a co-operative society but its business is entirely different and that is the banking business, which is governed and regulated by the provisions of the Banking Regulation Act, 1949. Only the Primary Agricultural Credit Societies with their limited work of providing credit facility to its members continued to be governed by the ambit and scope of deduction under Section 80P of the Act. (Paragraph 13 of the Judgment).
2. The banking business, even though run by a Co-operative bank is sought to be excluded from the beneficial provisions of exemption or deduction under Section 80P of the Act. The purpose of bringing on the statute book sub-section (4) in Section 80P of the Act was to exclude the applicability of Section 80P of the Act altogether to any co-operative bank and to exclude the normal banking business income from such exemption/deduction category. The words used in Section 80P(4) are significant. They are: "The provisions of this section shall not apply in relation to any co-operative bank other than a primary agricultural credit society .....". **The words "in relation to" can include within its ambit and scope even the interest income earned by the respondent-assessee, a co-operative Society from a Co-operative Bank. This exclusion by Section 80P(4) of the Act even though without any amendment in Section 80P(2)(d) of the Act is sufficient to deny the claim of the respondent assessee for deduction under Section 80P(2)(d) of the Act.** The only exception is that of a primary agricultural credit society. (Paragraph-14 of the judgment)
3. The amendment of Section 194A(3)(v) of the Act excluding the Co-operative Banks from the definition of "Co-operative Society" by Finance Act, 2015 and requiring them to deduct income tax at source under Section 194A of the Act also makes the legislative intent clear that the Co-operative Banks are not that specie of genus co-operative society, which would be entitled to exemption or deduction under the special provisions of Chapter VIA in the form of Section 80P of the Act. (Paragraph 15 of the Judgment)
4. If the legislative intent is so clear, then it cannot be contended that the omission to amend Clause (d) of Section 80P(2) of the Act at the same time is fatal to the contention raised by the Revenue before this Court and sub silentio, the deduction should continue in respect of interest income earned from the co-operative bank, even though the Hon'ble Supreme Court's decision in the case of Respondent assessee itself is otherwise. (Paragraph 16 of the Judgment)
5. On the decision of the earlier decision of the Hon'ble Karnataka High Court referred to in the earlier part of this order, the Court held that it did not find any detailed discussion

*of the facts and law pronounced by the Hon'ble Supreme Court in the case of the respondent assessee (Totagars Sales Co-operative society) and hence unable to follow the same in the face of the binding precedent laid by the Hon'ble Supreme Court. The Hon'ble Court observed that in paragraph 8 of the said order passed by a co-ordinate bench that the learned Judges have observed that*

*"the issue whether a co-operative bank is considered to be a co-operative society is no longer res integra, for the said issue has been decided by the Income Tax Appellate Tribunal itself in different cases....."*

*No other binding precedent was discussed in the said judgment. Of course, the Bench has observed that a Co-operative Bank is a specie of the genus co-operative Society, with which we agree, but as far as applicability of Section 80P(2) of the Act is concerned, the applicability of the Supreme Court's decision cannot be restricted only if the income was to fall under Section 80P(2)(a) of the Act and not under Section 80P(2)(d) of the Act.(Paragraph-18 of the Judgment)*

6. *The Court finally concluded that it would not make a difference, whether the interest income is earned from investments/deposits made in a Scheduled Bank or in a Co-operative Bank. Therefore, the said decision of the Co-ordinate Bench is distinguishable and cannot be applied in the present appeals, in view of the binding precedent from the Hon'ble Supreme Court." (Paragraph 19 of the Judgment)*

11. *The Hon'ble Karnataka High Court in the aforesaid decision also placed reliance on a decision of the Hon'ble Gujarat High Court in the case of **STATE BANK OF INDIA (SBI) vs. COMMISSIONER OF INCOME TAX** 389 ITR 0578 (Guj) did not agree with the view taken by the Karnataka High Court in Tumkur Merchants Souharda Credit Cooperative Ltd. (supra) that the decision of the Supreme Court in Totgars Co-operative Sale Society (supra) is restricted to the sale consideration received from marketing agricultural produce of its members which was retained in many cases and invested in short term deposit/security and that the said decision was confined to the facts of the said case and did not lay down any law. The Hon'ble Gujarat High Court held that in the case of Totgars Co-operative Sale Society (supra) decided by Hon'ble Supreme Court, the court was dealing with two kinds of activities: interest income earned from the amount retained from the amount payable to the members from whom produce was bought and which was invested in short-term deposits/securities; and the interest derived from the surplus funds that the assessee therein invested in short-term deposits with the Government securities. The Hon'ble Gujarat High Court in this regard referred to the decision of the Karnataka High Court from which the matter travelled to the Supreme Court wherein it was the case of the assessee that it was carrying on the business of providing credit facilities to its members and therefore, the appellant-society being an assessee engaged in providing credit facilities to its members, the interest received on deposits in business and securities is attributable to the business of the assessee as its job is to provide credit facilities to its members and marketing the agricultural products of its members. The Hon'ble Gujarat High Court therefore held that decision in the case of Totagar Co-operative Sales Society rendered by the Hon'ble Supreme Court is not restricted only to the investments made by the assessee therein from the retained amount which was payable to its members but also in respect*

*of funds not immediately required for business purposes. The Supreme Court has held that interest on such investments, cannot fall within the meaning of the expression "profits and gains of business" and that such interest income cannot be said to be attributable to the activities of the society, namely, carrying on the business of providing credit facilities to its members or marketing of agricultural produce of its members. The court has held that when the assessee society provides credit facilities to its members, it earns interest income. The interest which accrues on funds not immediately required by the assessee for its business purposes and which has been invested in specified securities as "investment" are ineligible for deduction under section 80P(2)(a)(i) of the Act. (Paragraph-13 of the Judgment)*

*12. It can thus be seen that the ratio laid down by the Hon'ble Karnataka High Court in the case of Totalgars Cooperative Sales Society in 395 ITR 611 (Karn) is that in the light of the principles enunciated by the Supreme Court in Totgars Co-operative Sale Society (supra), in case of a society engaged in providing credit facilities to its members, income from investments made in banks does not fall within any of the categories mentioned in section 80P(2)(a) of the Act. **However, section 80P(2)(d) of the Act specifically exempts interest earned from funds invested in co-operative societies.** Therefore, to the extent of the interest earned from investments made by it with any co-operative society, a co-operative society is entitled to deduction of the whole of such income under section 80P(2)(d) of the Act. However, interest earned from investments made in any bank, not being a co-operative society, is not deductible under section 80P(2)(d) of the Act.*

6.5 On the basis of above discussions, and in the interest of Justice we remand this issue back to the Ld.AO to verify the interest earned from investments made in co-operative societies that is eligible for deduction under section 80P(2)(d) of the Act. The Ld.AO is directed to consider the claim in accordance with above observations.

**Accordingly these grounds raised by assessee stands allowed for statistical purposes.**

**7. Ground No.8** raised by assessee becomes academic at this stage and therefore do not require any adjudication.

**8. Ground No.9** is consequential in nature and therefore do not require any adjudication.

**Accordingly, the appeals filed by assessee for assessment years under consideration stands allowed for statistical purposes.**

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

Order pronounced in the open court on 30<sup>th</sup> August, 2021

Sd/-  
(CHANDRA POOJARI)  
Accountant Member  
Bangalore,  
Dated, the 30<sup>th</sup> Aug, 2021  
/Vms/

Sd/-  
(BEENA PILLAI)  
Judicial Member

**Copy to:**

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

By order

Assistant Registrar, ITAT, Bangalore

		<b>Date</b>	<b>Initial</b>	
1.	Draft dictated on	On Dragon		Sr.PS
2.	Draft placed before author	-8-2021		Sr.PS
3.	Draft proposed & placed before the second member	-8-2021		JM/AM
4.	Draft discussed/approved by Second Member.	-8-2021		JM/AM
5.	Approved Draft comes to the Sr.PS/PS	-8-2021		Sr.PS/PS
6.	Kept for pronouncement on	-8-2021		Sr.PS
7.	Date of uploading the order on Website	-8-2021		Sr.PS
8.	If not uploaded, furnish the reason	--		Sr.PS
9.	File sent to the Bench Clerk	-8-2021		Sr.PS
10.	Date on which file goes to the AR			
11.	Date on which file goes to the Head Clerk.			
12.	Date of dispatch of Order.			
13.	Draft dictation sheets are attached	No		Sr.PS