

Dear Assessing Officer- Please Co-operate With Co-operative Banks

(Tax liability in respect of various types of income of co-operative banks under the Income-Tax Act 1961)

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By S K Tyagi

Co-operative banking is being aided and encouraged by the State Governments vide the various provisions of State Co-operative Societies Acts. A co-operative bank is a co-operative society, which is union of persons established according to the principles of equality, the number of whose members is unlimited and the purpose of which is, by joint performance of economic acts, to improve the financial position of its members or the condition under which they carry on their profession, by means of either self help or self help with Government support, provided that all the profit made by the joint action shall be distributed in proportion to which each member has taken part in the business and not in proportion to the capital invested.

On its part the Central Government has, inter-alia, provided incentive for the growth of co-operative sector in the form of deduction from income of various co-operative societies under section (U/s) 80-P of the Income-Tax Act (I.T. Act or Act)1961. S.80-P falls under part C of chapter VI-A of the I.T. Act, which has for its heading, '**deduction in respect of certain incomes**'. The heading of S.80-P is '**deduction in respect of income of co-operative societies**'.

As already stated S.80-P has been incorporated in the I.T. Act with a view to encouraging and promoting the growth of co-operative societies in the economic life of the country. As the provision of S.80-P is intended to encourage and promote growth of co-operative societies, a liberal interpretation should be placed on the language employed in S.80-P.

2. Treatment of a co-operative society under the I.T. Act

A co-operative society is a taxable entity and for that purpose it is treated as an association of persons (AOP, for short) within the definition of 'person' U/s 2 (31) of the I.T.Act. The Madras High Court in the case of **C.I.T Vs Salem District Urban Bank Limited, 8 ITR p.269**, has held that the assessee, being a co-operative central bank registered under the Co-operative Societies Act 1912, was an **association of individuals** within the meaning of S.3 of the I.T. Act 1922. However, though for taxation purposes the status of a society is to be taken as an AOP, Ss.67-A and 86 of the I.T. Act 1961, have been specifically excluded from application to the case of their members.

Besides, as provided in Part I of the First Schedule to the Annual Finance Acts, a co-operative society is taxed at rates which are different from an AOP etc. The latest rates of income-tax in the case of co-operative societies, as per Finance (No.2) Act, 1998; are as follows :

Total Income	Rates of Income-Tax
(i) Upto Rs 10 ` ,000	10%
(ii) Between Rs 10,000 & Rs 20,000	Rs 1,000 plus 20% of the amount above Rs 10,000
(iii) Above Rs 20,000	Rs 3,000 plus 35% of the amount above Rs 20,000

As far as the members of a co-operative society are concerned, the income by way of dividends from the co-

-operative society is entitled to deduction U/s 80-L of the I.T. Act 1961.

3. Activities of co-operative banks

A co-operative bank is a co-operative society. Co-operative societies may be formed for the purpose of carrying out different activities. Some co-operative societies are formed mainly for mutual benefit activities, whereas others are formed for carrying out business activity. The activities of some of the co-operative societies may be mixed, viz partly mutual and partly business.

A receipt out of an activity involving the principle of mutuality can not partake the character of profit liable to tax. Therefore, the receipts of a co-operative society, wherein principle of mutuality is involved, are not exigible to income-tax. On the other hand, receipts from business activity (not involving mutuality) are liable to tax. S.80-P of the I.T. Act has provided a number of exemptions and deductions in respect of receipts or income from various kinds of activities carried on by co-operative societies. A co-operative society may have a number of activities. The income from such activities may be exempt from income-tax, whereas the income from other activities may not be so exempt.

4. Deduction U/s 80-P in respect of the income of co-operative banks

S.80-P of the I.T. Act allows straight deduction in the computation of total income of a co-operative society, which includes a co-operative bank. U/s 80-P (2) (a) (i) of the I.T. Act, in case of a co-operative society (or a co-operative bank) engaged in carrying on the business of banking or providing credit facilities to its members, the whole of the amount of profits and gains of business **attributable to** such activities, shall be exempt from income-tax.

(i) Purpose of S.80-P

S.80-P has been incorporated in the I.T. Act by way of an incentive, with a view to encouraging and promoting growth of co-operative sector in the economic life of the country. There are various types of exemptions enumerated under different heads in the section. Each is a distinct and independent head of exemption. If one has to ascertain whether a particular type of income of a co-operative society is exempt from tax, he will have to see whether such income falls within any of the several heads of exemption - **U P Co-operative Bank Ltd Vs C.I.T., 61 ITR p.563 (All) ;Surat Vankar Sahakari Sangh Ltd Vs C.I.T. , 79 ITR p.722(Guj).**

(ii) Societies or banks carrying on activities, only some of which fall under the exemptions

If a co-operative society carries on certain activity, income from which is exempted and also certain activity income from which is not exempted, the profits and gains attributable to the exempted activities shall enjoy the exemption and those attributable to the non-exempted activities shall be taxed. At the same time it is just and proper that in order to ascertain the income referable to non-exempt activities the proportionate expenditure out of the total expenditure, should be deducted, in order to arrive at the correct income from non-exempted activities.

Besides, if the society has income some of which is exempt under one clause and the other under another clause of S. 80-P (2) , both will enjoy exemption. In the case of **Allahabad District Co-operative Bank Ltd Vs Union of India , 83 ITR p.895 (All)**, during the relevant assessment year, the assessee bank earned Rs 2,02,477 from banking business and also earned income from sources other than banking but such income did not exceed Rs 15,000. It has been held that the entire income enjoyed exemption. The decision in the case of **Addl.**

C.I.T Vs U P Co-operative Cane Union 114 ITR p.70 (All.), is also relevant in this context.

(iii) **Liberal Construction, when possible**

As the provision of S.80-P is intended to encourage and promote the growth of co-operative societies, a liberal construction should be placed on the language employed in the provision – **C.I.T. Vs South Arcot District Co-operative Marketing Society Ltd, 176 ITR p.117 (S.C) ; Broach District Co-operative Cotton Sales, Ginning and Pressing Society Ltd, Vs C.I.T., 177 ITR p.418 (S.C)**

The benevolent purpose of the exemption scheme U/s 80-P (2) (a) (iii) is to encourage a vital national activity in the interest of rural economy. Therefore, the term ‘marketing’ occurring in that section has to be construed in a manner which would achieve the benevolent purpose of exemption rather than defeat the said purpose– **Meenachil Rubber Marketing & Processing Co-operative Society Ltd Vs C.I.T., 193 ITR p.108 (Ker)**

(iv) **Computation of deduction**

A Co-operative society is entitled to deduction only on its **net amount of profits and gains**, i.e. on income of its business otherwise computable in accordance with the provisions of the I.T. Act for the purpose of charging income-tax thereon and which is included in its total income, and not on the amount of its gross profits and gains of business. –**Sabarkantha Zilla Kharid Vechan Sangh Ltd Vs C.I.T., 203 ITR p.1027 (SC)** The Special Bench of the I.T.A.T., Nagpur, in the case of **Second I.T.O Vs Nagpur Zilla Krishi Audhogik Sahakari Sangh Ltd, 2 I.T.D p.138**, considered the definition of ‘gross total income’ in S.80-B(5) and in view thereof, held that deduction should be allowed on the total income as computed under the provisions of the Act and not on the gross income.

The deduction U/s 80-P is from gross total income determined in accordance with other provisions of the Act. Therefore, unabsorbed losses of earlier years are to be set off before allowing deduction U/s 80- P – **C.I.T. Vs Kottagiri Industrial Co-operative Tea Factory Ltd, 224 ITR p.604 (SC)**.

Here a reference may also be made to the decision of the I.T.A.T in the case of **Shree Madhi Vibhag Khand Udyog Sahakari Mandli Ltd, Vs I.T.O, 19 T.T.J (Ahd) p.160**. It was held in this case that by the very nature of the scheme of the Act, it is clear that relief U/s 80-P, cannot be allowed before adjustment of unabsorbed depreciation and development rebate and , therefore, the deductions in regard to unabsorbed development rebate and past losses have to be made first, in order to determine the total income- in view of the provisions of S.80-B (5).

A society is not disentitled from claiming exemption only because it also carries on the activities , the income from which is not exempt. All sales of specified commodities to members, irrespective of their proportion and quantum , would belong to exempted category and such sale to non-members, irrespective of their

proportion and quantum, would belong to non-exempt category. –**C.I.T. Vs Nagpur Jilla Krishi⁴ Audyogik Sahakari Sangh Ltd, 209 ITR p.481(Bom)**. Similarly if a co-operative society carries on certain activities, income from which is exempt and also certain activities, income from which is not exempt ; only profits attributable to exempted activities shall enjoy exemption – **C.I.T. Vs Ratanabad Co-operative Housing Society Ltd, 215 ITR p.549 (Bom)**, Likewise, the Gujrat High Court in the case of **C.I.T. Vs Broach District Co-operative Cotton Sales, Ginning & Pressing Society Ltd, 97 ITR p.575 (Guj)**; has laid down that if a

society carries on certain activities which are exempted and certain other activities which are non-exempted, the profits and gains attributable to such non-exempted activities must necessarily be taxed.

(v) Deduction of expenses on proportionate basis

Where the co-operative society was earning income which was partly taxable and partly entitled to special deduction U/s 80-P, proportionate share of expenses attributable to the earning of income which is entitled to deduction, should be deducted in computing such income for the purpose of deduction U/s 80-P –**Kota Co-operative Marketing Society Ltd Vs C.I.T., 207 ITR p.608 (Raj)**. Similarly where assessee society has maintained a composite account of expenses in respect of both exempt income and taxable income, expenses related to non-exempt income have to be estimated, and expenses found to be incurred for exempted activities, have to be deducted from assessee's income before allowing deduction U/s 80-P – **C.I.T. Vs Rajasthan Rajya Sahakari Upphokta Sangh Ltd, 215 I T R, p.448 (Raj)**

(vi) Computation of income necessary

Though certain incomes of a co-operative society may be wholly exempt from income-tax U/s 80-P, yet it is necessary that proper computation of income is made in the return of income. The exemption granted under the I.T. Act 1961 are of two kinds. Certain classes of income are exempted from tax and also excluded from the computation of total income, while certain other classes of income exempted from tax are to be included in the assessee's total income. The former types of income fall under chapter III which comprises Ss 10,10-A, 10-B, and 11 etc. The latter types of income fall under chapter VI -A, which comprises sections 80-A to 80-U. Further in latter types of cases return of income is required to be filed, which is not the case regarding former types of income. Therefore, it is necessary to compute the income of a co-operative society from business under the relevant provisions of the I.T. Act, even though it may be exempt U/s 80-P. – **Chatrapati Shivaji Sakhar Karkhana Ltd Vs C.I.T. 115 ITR p.312(Bom)**.

5. Significance of the term profits & gains of business attributable to one or more of such activities

It is important for us, while interpreting the provisions of S. 80-P, to understand the significance of the fact that U/s 80-P (2) (a) and 80-P (2) (c) , the whole of the amount of profits and gains of business attributable to the activities enumerated therein, shall be deducted from the income of the co-operative society. The term 'attributable to' has not been used in Ss 80-P (2) (b), 80-P (2) (d), 80-P (2) (e), and 80-P (2) (f) .

The expression 'attributable to' is of very wide import as clearly held in the case of **Cambay Electric Supply Industrial Co. Ltd Vs C.I.T., 113 ITR p.84 (SC)**. The Supreme Court in the case of **C.I.T. Vs Bangalore District Co-operative Central Bank Ltd, 233 ITR p.282** has appreciated the significance of the term 'attributable to' as used in 80-P (2) (a). In view thereof the Apex Court, in the above case, has held that interest on Government securities and dividends on shares of Industrial Finance Corporation were entitled to deduction U/s 80-P (2) (a)(i), because such income was held by the I.T.A.T. as attributable to assessee's business. The Apex Court in the aforesaid case had not followed its earlier decision in the case of **M.P Co-operative Bank Ltd Vs C.I.T., 218 ITR p.438**. The reason given for the same is that the decision in 218 ITR was rendered on the facts of that case.

With due respect, it may be pointed out that whereas the earlier decision in the case of **M. P. Co-operative Bank Ltd Vs Addl. C.I.T. 218 ITR p.438**, was rendered under of the provisions of erstwhile S.81, the latter decision in the case of **C.I.T. Vs Bangalore District Co-operative Central Bank Ltd, 233 ITR p.282** was rendered under of the provisions of S. 80-P. In this context it is important to note that the language of erstwhile S.81 (i) was materially different from the one used in present S. 80-P (2) (a).

In view of the aforesaid reasons the decision of the Apex Court in 233 ITR p. 282 is perfectly correct because of the language used in S.80-P (2) (a), where under the whole of amount of profits and gains of business **attributable to** any one or more of such activities, is entitled to deduction.

6. Deduction in respect of income from banking business etc

U/s 80-P (2) (a) (i), in the case of a co-operative society engaged in carrying on the business of banking or providing credit facilities to its members, the whole of the amount of profits and gains of business **attributable to** such activity shall be exempt from income-tax.

(i) Interest earned by co-operative banks from Government securities held by them as their stock-in-trade, qualifies for exemption.

It was held by the Apex Court in the case of **C.I.T. Vs Bombay State Co-operative Bank Ltd, 70 ITR p.86(SC)**, that interest earned by co-operative societies from Government securities held by them as their stock -in-trade, qualifies for exemption. Similarly it was held by a number of High Courts that interest on securities held as stock-in-trade by Co-operative Banking Institutions is exempt –**Addl. C.I.T. Vs Rajasthan State Co-operative Bank Ltd, 163 ITR p.213 (Raj)**; **U.P Co-operative Bank Ltd Vs C.I.T., 61 I.T.R p.563 (All.)**; **Malabar Co-operative Central Bank Ltd Vs C.I.T., 101 ITR p.8 (Ker)**; **C.I.T. Vs Madurai District Central Co-operative Bank Ltd, 148 ITR p.196 (Mad)**. In the case of **C.I.T. Vs Bhopal Co-operative Central Bank Ltd, 164 ITR p.713 (M P)**, it was held that interest on securities maintained by a co-operative society in compliance with S.24 of Banking Regulation Act 1949, is exempt, Similarly in the case of **Addl. C.I.T. Vs Ahmedabad District Co-operative Bank Ltd, 101 ITR is p.733 (Guj)**, it was held that income from investment of surplus funds in easily realisable Government Securities / Municipal Debentures by banking co-operative society will qualify for deduction. The Madras High Court in the case of **C.I.T Vs Madurai District Central Co-operative Bank Ltd, 148 ITR p.196 (Mad)** has held that exemption is available in respect of interest from securities and subsidies received from Government for

opening new branches. Similarly the Madras High Court in the case of **C.I.T. Vs Madurai District Central Co-operative Bank Ltd, 224 ITR p.237 (Mad)**, has held that interest on securities, subsidies received from Government and dividends received by the assessee co-operative bank, were business income entitled to deduction U/s 80-P(2) (a) (i). Likewise interest on securities received by a co-operative bank was held to be business income of the assessee entitled to deduction U/s 80-P(2) (a) (i), in the case of **C.I.T. Vs Ramanathpuram District Central Co-operative Bank Ltd, 224 I.T.R. p.226(Mad)**.

As against the aforesaid decisions of the various High Courts, the M.P. High Court in the case of **M.P. State Co-operative Bank Ltd Vs Addl. C.I.T. , 119 I T R p. 327 (M.P.)** , has held that in case of income of a society from interest earned on reserve fund and provident fund invested in Government securities was not exempt, because the assessee co-operative bank was statutorily forbidden from using the same in its business

and, therefore, it did not form the assessee's stock-in-trade. The aforesaid judgement of the M. P. High Court has been confirmed by the Apex Court in its decision reported in 218 ITR p.438. Similarly, the Rajasthan High Court in the case of **C.I.T. Vs Rajasthan State Co-operative Bank, 88 Taxman p.98 (Raj)**, has held that interest earned by assessee co-operative bank formed under Rajasthan Co-operative Societies Act, by investing reserve fund in Government securities, is not income derived from banking business and, therefore, is not exempt U/s 80-P (2) (a) (i). Same was the decision of M.P. High Court in the case of **C.I.T. Vs Jilla Sahakari Kendriya Bank Maryadit , 225 ITR p.421 (M.P.)**

(ii) Miscellaneous receipts attributable to banking business of a co-operative bank

It was held in the case of **C.I.T Vs Jilla Sahakari Kendriya Bank Maryadit 225 ITR p.421 (M.P.)** , that as according to the Tribunal the receipts were attributable to the banking business of the assessee, the same were entitled to deduction U/s 80-P

(iii) Income from locker rent, whether exempt U/s 80-P

It was held by the M.P. High Court in the case of **Bhopal Co-operative Central Bank Vs C.I.T. , 169 ITR p.573 (M.P)** that income from locker rent cannot be co-related to the business of banking and, therefore, the same was not exempt U/s 80-P (2) (a)(i). But it was held exempt U/s 80-P (2) (c). The aforesaid decision was followed in the case of **C.I.T. Vs Jilla Sahakari Kendriya Bank Maryadit, 225 ITR p.421 (M.P)**

(iv) Interest on Government securities , whether entitled to exemption U/s 80-P (2) (a) (i)

There has been a big controversy regarding the issue whether interest on Government securities held by a co-operative bank is entitled to deduction U/s 80-P(2)(a) (i). In view of the provisions of S.24 of the Banking Regulation Act,1949 every bank is required to maintain in cash, gold or approved securities valued at a price not exceeding the current market price, an amount which shall not be less than 20% of its total liabilities etc. Then, there are provisions laid down by the State Co-operative Societies Acts, where under the securities earmarked to reserve fund, cannot be withdrawn except with the permission of the Registrar to meet losses or at the time of winding up. As far as the securities purchased by the co-operative banks under the provisions of the Banking Regulation Act 1949, are concerned, interest thereon must be treated as part of income from banking business and, therefore, the same will enjoy exemption U/s 80-P (2) (a) (i). However, regarding the

securities earmarked to reserve fund as required by the State Co-operative Societies Acts, the position is⁷ not so straight and clear.

The first important case on this issue is **Bihar State Co-operative Bank Ltd Vs C.I.T. 39 ITR p.114 (SC)**, wherein it was held that interest from short-term deposits made by the co-operative bank with the Imperial Bank of India, was exempt from tax. The relevant part of the aforesaid decision is as follows:

“Held , that as the appellant was a bank and one of its objects was to carry on the general business of banking, its normal business was to deal in money and credit and did not consist only of receiving deposits and lending money to its members or other societies. It was a normal mode of carrying on banking business to invest moneys in such a manner that they are readily available. The money laid out in the form of deposits did not cease to be part of the appellant’s circulating capital. The interest from the deposits arose from the business of the bank and was exempt from income-tax under the notifications, and nothing turned on the manner in which the appellant chose to show this income in its return”.

Thereafter, the Gujrat High Court in the case of **Addl. C.I.T. Vs Ahmadabad District Co-operative Bank Ltd, 101 ITR p.733**, has held that investment by a bank of its surplus and idle funds in easily realisable securities, debentures or deposits was a part of stock-in-trade and, therefore, interest thereon was entitled to deduction U/s 80-P. Similarly Madras High Court in the case of **C.I.T. Vs Madurai District Central Co-operative Bank Ltd, 118 ITR p.196** held that holding of securities as per the requirements of Banking Regulation Act and directions of Reserve Bank of India, was a part of banking business and interest from such securities was attributable to the business of the bank and therefore, exemption from tax was available in respect of such interest. In this case the Hon’ble High Court has dealt with the meaning of ‘**attributable to**’ occurring in S.80-P (2) (a) (i). The aforesaid decision was later on followed in the cases of **C.I.T. Vs Madurai District Central Co-operative Bank Ltd, 224 ITR p.237 (Mad)** and **C.I.T. Vs Ramnathpuram District Central Co-operative Bank Ltd, 224 ITR p.226 (Mad)**.

Second important decision on the issue is in the case of **C.I.T. Vs Bombay State Co-operative Bank Ltd, 70 ITR p.286 (SC)**, wherein it was held that interest received from Government securities held by a co-operative society as its stock- in- trade, qualifies for exemption and the exemption was inapplicable only to interest received from Government securities held by the society as investment.

The M.P High Court had to deal with an entirely different but connected issue in the case of **M.P. Co-operative Bank Ltd Vs Addl. C.I.T., 119 ITR p.327**. The co-operative bank , U/s 43 (2) of the M P Co-operative Societies Act 1960, was required to transfer, unless exempted by a general or a special order of the Registrar, atleast 25% of its profits to a reserve fund. S.44(2) of the Act provided that the reserve fund of the society would be invested or utilised only in such manner and on such terms and conditions as laid down by the Registrar in this behalf. The M P High Court in this case, held that the investment of reserve fund in securities was not to be meet the withdrawal by depositors or other transactions as was the case with the circulating capital or stock-in-trade and the reserve fund could not be taken to be the circulating capital or stock-in-trade of the assessee, as the same could be utilised only when permitted by the Registrar in case of

loss or winding-up. It was, therefore, held that income from investment of reserve capital in securities was not a part of income from the banking business and hence it did not qualify for exemption. The aforesaid decision of the M P High Court was affirmed by the Apex Court in the case of **M P Co-operative Bank Ltd, Vs Addl C.I.T , 218 ITR p.438 (SC)**. The Rajasthan High Court in the case of **C.I.T. Vs Rajasthan State Co-operative Bank** followed the aforesaid decision of the Apex Court as the facts were similar and accordingly held that income from investment in Government securities of the reserve fund, was not from banking business and, therefore, not entitled to exemption U/s 80-P (2) (a) (i).

The aforesaid decision of the Apex Court reported in 218 ITR p.438, has however, not been followed by the Supreme Court in its later judgement in the case of **C.I.T. Vs Bangalore District Co-operative Central Bank Ltd, 233 I.T.R p.282 (SC)**. In this case interest on Government securities and dividends on shares of Industrial Finance Corporation were held as exempt U/s 80-P (2) (a) (i), in view of the fact that the interest income was **attributable to** the business of the assessee.

There is no conflict between the aforesaid two decisions of the Supreme Court

Regarding the decisions of the Supreme Court in the cases of **M P Co-operative Bank Ltd Vs Addl. C.I.T., 218 ITR p.438** and **C.I.T. Vs Bangalore District Co-operative Central Bank Ltd, 233 ITR p.282**, it is important to note that the judgement in the former case was rendered under erstwhile S.81 (i), whereas the decision in the latter case was rendered under the present S.80-P (2) (a) of the Income-tax Act. The relevant part of erstwhile S.81 is as follows :

Income of Co-operative Societies –Income-tax shall not be payable by a co-operative society—

- (i) in respect of the profits and gains of business carried on by it, if it is –
 - (a) a society engaged in carrying on the business of banking or providing credit facilities to its members ; or --
 -
- provided that -----”.

The relevant part of S.80-P is ,however ,different which is as follows:

80-P (2) - The sum referred to in S. 80-P (1) shall be following

- (a) in the case of a co-operative society engaged in-
 - (i) Carrying on the business of banking or providing credit facilities to its members, or -----
- the whole of the amount of profits & gains of business **attributable to** any one or more of such activities.
- Provided that -----”.

Regarding the use of the term “Profits and gains of business attributable to such activities” in S. 80-P (2) (a) one may refer to the decision of the Apex Court in the case of **Cambay Electric Supply Industrial Company Ltd, Vs C.I.T., 113 ITR p.84 (SC)**, wherein it has been held that the expression ‘**attributable to**’ is of very wide import and therefore, it will cover receipts from sources other than the actual conduct of the business of banking.

In view of the aforesaid reasons, even the income by way of interest on securities earmarked to a reserve fund as required under various State Co-operative Societies Acts; will be treated as income '**attributable to**' the banking business of the co-operative society and accordingly it will be entitled to deduction U/s. 80-P (2) (a) (i).

7. Some important decisions in respect of co-operative banks

There have been a number of disputes regarding the exemption in respect of the various types of income of co-operative banks. The co-operative banks are, on the one hand, governed by the various provisions of the Banking Regulation Act 1949; and on the other hand, they are also governed by the respective State Co-operative Societies Acts.

Under S.24 of the Banking Regulation Act 1949, every bank is required to maintain in cash, gold or approved securities an amount which shall not be less than 20% of its total liabilities etc. As already pointed out in para 7.1, the securities purchased by the co-operative banks under the provisions of the Banking Regulation Act,

have been held to be a part of the stock-in-trade or the circulating capital of the bank and the interest on such securities has, therefore, been held to be exempt U/s 80-P (2) (a) (i)

Besides, as already pointed out earlier, there are provisions laid down by the State Co-operative Societies Acts, where under certain securities are earmarked to a reserve fund, no part of which can be withdrawn except with the permission of Registrar to meet losses or at the time of winding-up of the society. A reference has been made to the decisions of the Apex Court in the cases of **M.P. Co-operative Bank Ltd Vs Addl. C.I.T., 218 I.T.R. p.438** and **C.I.T. Vs Bangalore District Co-operative Central Bank Ltd, 233 I.T.R p.282** and thereafter it has been stated that the income by way of interest on securities earmarked to a reserve fund as required under the various State Co-operative Societies Acts, will also be treated as income attributable to the banking business of the co-operative societies and accordingly it will be entitled to deduction U/s 80-P (2) (a)(i).

As far as Co-operative Banks, in the State of Maharashtra, are concerned, they are governed by the various provisions of the Maharashtra Co-operative Societies Act 1960. As per S.66 of this Act every society which does or can derive a profit from its transactions shall maintain a reserve fund. A profit earning society has to maintain a **reserve fund** from its profit derived from its transactions and the society has to carry atleast one-fourth of its net profits each year to the reserve fund. Such fund may be invested under the direction of the Government or may be utilised in furtherance of the object of this Act with permission of the Government. The Registrar may permit a society to earmark to the reserve fund a lower percentage of its profits which shall not be less than one-tenth of the net profits. S.70 of this Act lays down regulations for investment of funds of a society. Though discretion is given to the societies to invest their fund in any of the institutions provided in this section, any rule or bye-law providing for investment in any manner other than the one

prescribed under this section shall not be valid. Thus co-operative banks in the State of Maharashtra also are required to maintain a **reserve fund** and invest the same in the prescribed manner. However, as such creation and investment of reserve fund is statutory requirement, the income from such investment will be treated as income attributable to the banking business of the co-operative society and accordingly it will enjoy exemption U/s 80-P (2) (a) (i).

Important decisions of the I.T.A.T

There are a number of decisions of the I.T.A.T. in respect of exemption of income of co-operative banks U/s.80 P (2) (a) (i). Some of these decisions are briefly dealt with ,as follows :

I.T.O Vs Karnataka State Co-operative Apex Bank Ltd, 6 I.T.D. p.673 (Bang) - It was held in this case that a co-operative society engaged in the business of providing credit facilities to its members is eligible for deduction U/s 80-P, on interest received from securities purchased out of reserve fund. Similarly the Jaipur Bench of the I.T.A.T in the case of **Rajasthan Rajya Sahakari Bhoomi Vikas Bank Ltd Vs I.T.O , 19 I.T.D p.674**, has held that income received by the assessee co-operative bank, on various securities, would be exempt U/s 80- P(2)(a) (i). Likewise it was held in the case of **I.T.O Vs Zila Sahakari Bank Ltd 16 T.T.J (All) p.530**, that a co-operative bank would be entitled to exemption on income from interest on Government securities U/s 80-P(2) (a) (i). Same was the view taken by the Nagpur Bench of the I.T.A.T. in the case of **I.T.O Vs Raipur Co-operative Central bank Ltd, 26 T.T.J (Nag) p.514**, wherein it was held that income from securities in reserve fund account and gratuity fund account, is also eligible for exemption U/s 80-P(2) (a) (i). In this context the decision of the Bombay Bench of the I.T.A.T. in the case of **Parsik Janata Sahakari Bank Ltd Vs I.T.O., 50 I.T.D p.318**, is quite relevant. It was, inter alia, held in this case

that S.70 of the Maharashtra State Co-operative Societies Act requires every co-operative society engaged in banking activity to deposit its surplus fund in a particular manner under the pain of prosecution for default.

When such is the position in law, it would be difficult to comprehend that the income from investments in the manner prescribed under the law would be any thing but income from banking activities carried on by the co-operative society. And accordingly it was held that the assessee could not be denied exemption in respect of such interest income.**I.T.O Vs Gujrat State Co-operative Land Development Bank Ltd, 8 I.T.D p.354 (Ahd)** - It was held in this case that it would not be correct to say that a co-operative society which provided credit facilities to its members was not carrying on banking business. The I.T.A.T. relied on the decision of the Apex Court in the case of **Bihar State Co-operative Bank Ltd Vs C.I.T 39 I.T.R p.114**, wherein it was held that the main business of the banking in a general sense is to give credit facility to the customers and, therefore, it was difficult to appreciate the contention that the activity of banking and the activity of providing credit facilities are two distinct and mutually exclusive activities.

Rental Income

The Bombay Bench of the I.T.A.T. in the case of **Saraswat Co-operative Bank Ltd Vs I.T.O., 11 I.T.D. p.723**, has laid down that letting out a portion of the buildings acquired by the banking company in the co-operative sector for purposes of its banking business, which were in the occupation of tenants, was incidental to the carrying on of its banking business and, therefore, the rental income could be treated as income from banking business for purposes of S. 80-P(2) (a) (i) and 80-P(2) (c), although it was shown in the return of income under the head 'Income from other sources'.

Income from other allied activities :

Commission income earned by assessee co-operative bank, on **discounting of bills** would be exempt U/s 80-P(2) (a) (i)- **Rajasthan Rajya Sahakari Bhoomi Vikas Bank Ltd Vs I.T.O , 19 I.T.D p.674**. Similarly it was held in the case of **Maharashtra State Co-operative Land Development Bank Ltd Vs I.T.O , 41 I.T.D p.419 (Bom)**, that dividend income received by a co-operative society engaged in banking business from shares held in Government Corporation would qualify as its income from its banking business eligible for exemption U/s 80-P(2) (a) (i). It was observed in this case by the Hon'ble I.T.A.T. that such dividend income was attributable to the banking business. It was further observed that it cannot be said that since dividend fell U/s80-P(2) (d) , it could not be considered U/s 80-P(2) (a) (i), because first the clauses (a) & (d) of S. 80-P(2) are not mutually exclusive and secondly since they are a piece of beneficial legislation, they will have to be interpreted in such a manner as to substantially advance the object and policy underlying this part of the enactment. In yet another decision in the case of **Ahmednagar District Central Co-operative Bank Ltd Vs I.T.O, 33 I.T.D p. 683 (Pune)**, it was held that where the assessee co-operative society carrying on banking business, earned income by way of **commission** from State Electricity Board for collecting electricity bills from public, commission income was **attributable to** the banking business and, therefore, qualified for exemption U/s 80-P(2) (a) (i).

In another decision in the case of **I.T.O Vs Rajasthan State Co-operative Bank Ltd, 21 I.T.D p.617 (Jp)**, it was held that charges realised by co-operative banking concern on account of issue of duplicate pass books and certain other charges incidental to the banking activity like brokerage and on account of sale of stationery

and related items, clearly arise out of the banking business and have to be treated as income from banking only. It was also held that where the assessee co-operative banking company advanced loans for construction of warehouse, income received by assessee on account of supervision and technical assistance was to be treated as assessee's business income and not as income from other sources. It was observed in this case that since the supervision and technical assistance that was provided by the assessee, was only to those persons to whom advances were given, it was clearly in the nature of providing services related to the loans and , therefore, they were clearly the banking activity. Likewise in the case of **I.T.O Vs Gujrat State Co-operative Land Development Bank Ltd, 8 I.T.D p. 354 (Ahd.)**, it was held that assessee co-operative society's income by way of interest on (i) trust securities, (ii) loans and securities included in statutory reserve, (iii) short term deposits with a bank(iv) staff provident fund investments, and (v) staff loans; would be eligible for deduction U/s 80-P(2) (a) (i).

In yet another decision in the case of **Ambala Central Co-operative Bank Ltd Vs I.T.O 8 I.T.Dp.795 (Chd)**, it was held that provision for loss from bad and doubtful debts by assessee banking co-operative

society could not be included in computation of assessee's income. In this case the I.T.O had added back the aforesaid sum while computing the taxable total income of the assessee on the ground that being a reserve and the debts not having been actually written-off during the year under consideration, the provision for bad and doubtful debts could not be allowed. In this context the Hon'ble I.T.A.T. observed that the debit to the accounts made by the assessee by way of provision for bad and doubtful debts had direct and proximate connection with or nexus to earning that income of the assessee which was exempt U/s 80-P(2) (a) (i) and, therefore, the same could not be included in the computation of income from sources other than banking activity of the assessee which were taxable. A very interesting issue had arisen in the case of **Shri Mahavir Co-operative Bank Ltd Vs I.T.O , 37 I.T.D. p.130**, before the Pune Bench of the I.T.A.T. The issue was whether profits arising on sale of property by assessee co-operative bank, which was acquired by it in satisfaction of a debt, was attributable to assessee's banking activity. It was held by the Hon'ble I.T.A.T. that the aforesaid profit was not attributable to the assessee's banking business and, therefore, not exempt U/s 80-P(2) (a) (i).

8. Conclusion

From the aforesaid discussion it may be safely concluded that the income of a co-operative bank from banking business or any other activity attributable to banking business will be fully exempt U/s 80-P (2)(a)(i). As pointed out earlier the requirement for creating a reserve fund under State Co-operative Societies Acts, is a statutory requirement and therefore, the investment in Government securities earmarked to such reserve fund, shall be considered as attributable to the main business i.e banking business of the co-operative bank and hence interest on such Government securities shall be entitled to exemption U/s 80-P (2)(a)(i) of the I.T.Act .

S. K. TYAGI	Office : (020) 613 3012	Flat No.2, (First Floor)
M.Sc., LL.B., Advocate	Fax : (020) 612 1131	Gurudatta Avenue
Ex-Indian Revenue Service	Residence : (020) 668 2032	Popular Heights Road
Income-Tax Advisor	: (020) 668 2444	Koregaon Park
	E-mail : sktyagidt@vsnl.com	PUNE - 411 001
