

**IN THE HIGH COURT FOR THE STATE OF TELANGANA
AT HYDERABAD**

**THE HONOURABLE SRI JUSTICE P. SAM KOSHY
AND
THE HONOURABLE SRI JUSTICE NARSING RAO NANDIKONDA
INCOME TAX TRIBUNAL APPEAL NO.132 OF 2010**

Date: 26.03.2026

Between:

The Ismailia Co-operative Credit Society Ltd.

...Appellant

AND

***Assistant Commissioner Income Tax,
Circle 5(1), Hyderabad.***

...Respondent

JUDGMENT: *(As per the Hon'ble Sri Justice Narsing Rao Nandikonda)*

Heard **Mr. A.V. Siva Karthikeya**, representing **Mr. A.V.S. Krishna Koundinya**, learned counsel for the appellant and **Mr. K. Sudhakar Reddy**, learned Senior Standing Counsel for Income Tax Department appearing for the respondent.

2. This Memorandum of Appeal is filed under Section 260A of the Income Tax Act, 1961 aggrieved by the order of the Income Tax Appellate Tribunal, Hyderabad Bench 'A' in

I.T.A.No.1187/Hyd/2007 (Assessment year 2004-05) dated 25.04.2008.

3. The brief facts of the case are that the appellant herein is a cooperative society engaged in the business of providing credit facilities to its members. The appellant filed returns for the assessment year 2004-05 showing an income of Rs.33,35,549/-, which included interest income of Rs.31,63,578/- and claimed deduction under Section 80P of the Income Tax Act, 1961 (for short 'IT Act'), contending that the interest income derived from deposits was attributable to the business of providing credit to the members of the assessee society.

4. Further, it was contended that as part of activities of the society, the appellant deposited funds with the bank whenever their funds were not required and these funds were kept in a bank account for safe custody so that the said deposits would yield some interest. The activity of keeping such funds in deposit and deriving interest income was a regular activity of the society and submitted that investment of funds in short-term deposits and earning interest there from is an activity attributable to the

business of the society and sought deduction under Section 80P(2) of the IT Act. However, the claim of the appellant was disallowed by the Assessing Officer on the following grounds that the assessee is not carrying on any banking activity and that the deposits made by the assessee in the bank may facilitate the business of the assessee. However, making such deposits is not the business of the assessee.

5. The Assessing Officer, vide order dated 29.12.2006 has held that the interest income derived by a society indulged in banking business or in the business of providing credit facilities to its members is exempt in its entirety. Section 80P(2)(d) of the IT Act will not have any application, and not having found a place in the IT Act. It was further held that Section 80P(2)(d) of the IT Act clearly provides that any interest income derived from investment with co-operative societies alone is not taxable. Thereby, the contention of the appellant was rejected.

6. Being aggrieved by the same, the appellant preferred an appeal before the Commissioner of Income Tax (Appeals)-V, Hyderabad, vide order dated 13.11.2007, has dismissed the

appeal confirming the order of the CIT (A). The relevant order of the learned Commissioner is extracted below:

“Relying on the ratio of the above decision of the Hon'ble jurisdictional High Court in the case of Anakapalli Co-operative Marketing Society Ltd. (supra), in my considered opinion, the interest income to the extent of Rs.31,63,578 earned by the appellant from the investment made with Development Credit Bank cannot be considered as income having been derived from the activity of providing credit facility to its members and hence, the same is not entitled for deduction u/s. 80P(2)(a)(i) of the 'Act'. It may be further mentioned here that such interest income derived by the appellant from the above investment did not constitute one of the sources of income attributable to activities of providing credit facilities to its members. In this view of the matter, the Assessing Officer was justified in disallowing the claim of the appellant for deduction u/s. 80P of the 'Act' and hence, the assessment order passed by him, bringing to tax the above amount of interest, is upheld.”

7. Aggrieved by the same, the present appeal is filed on the grounds that the learned Tribunal failed to consider that interest received from Development Credit Bank is attributable to the assessee's activity of providing credit facilities to its members, thereby erred in denying deduction under Section 80P(2) of the IT Act and it is further contended that the learned tribunal ought to have appreciated that the expression "attributable to"

occurring in Section 80P (2) of the IT Act is much wider than "derived from," suggests that the legislature intended to cover receipts from sources other than the actual conduct of the business of the assessee and it was further contended that the learned Tribunal ought to have seen that Section 80P(2) of the IT Act was enacted to promote the growth of Co-operative Societies and such provisions have to be constructed liberally.

8. Having perused the entire material on record and the following substantial question of law which would arise for the consideration before this Court is:

"Whether on the facts and circumstances of the case, the interest income earned by the assessee on bank deposits is eligible for deduction under Section 80P(2)(a)(i) of the Income Tax Act 1961?"

9. The learned counsel for the appellant contended that the Co-operative Society qualifies for and is entitled to claim deduction under Section 80P(2)(a)(i) of the IT Act. Whereas, the Assessing Officer treated the interest earned on deposits made with nationalised banks as "Income from Other Sources" and denied the deduction under Section 80P. He further contended that the appellant is engaged only in providing credit facilities to

its members which is undisputed and that the surplus funds deposited in banks represent the appellant's own funds generated from its business operations and these funds are not liabilities payable to members nor they are retained sale proceeds or trust amounts. The investment of surplus funds in bank deposits is a prudent business decision to safeguard and multiply funds and the interest earned is ultimately for the benefit of members and forms part of the circulating capital of the society.

10. Further, the appellant argued and contended that the judgment of the Hon'ble Supreme Court relied upon by the Revenue in **Totgars Cooperative Sale Society Limited**¹, is not applicable to the present set of facts and further relied upon the judgment of the jurisdictional High Court in the case **State Bank Cooperative Society**, which has extensively analysed Section 80P and its scheme and clarifies that Section 80P confers different categories of benefits such as activity based and investment based deductions.

¹322 ITR 283

11. The Court held that the temporary parking of surplus business income in nationalised banks does not alter the character of the income when the statute uses the expression "attributable to". The character of business income is not lost merely because it is temporarily invested pending deployment. The approach of revenue creates an artificial distinction without statutory basis and defeats the beneficial object of Section 80P and that denying the deduction merely because the investment was made in a nationalised bank and not in another co-operative society leads to an irrational classification. Hence, the interest income earned on surplus funds deposited in banks is eligible for deduction under Section 80P(2)(a)(i) and prayed to set aside the impugned orders.

12. The learned counsel for the appellant also relied upon the judgment in ITTA No.292 of 2010 and reference was also made to a judgment from the then **High Court of Telangana and Andhra Pradesh**².

²2017 396 ITR 371

13. The learned Senior Standing Counsel for Income Tax Department appearing for the respondent has argued and contended that the appellant is a Co-operative Credit Society engaged in providing credit facilities to its members and is not a co-operative bank. The deduction claimed under Section 80P(2)(a)(i) is only in respect of interest earned on deposits placed with non-co-operative bank (Development Credit Bank). In fact, Section 80P(1) allows deduction only in respect of income referred to in Section 80P(2), subject to statutory condition and under Section 80P(2)(a)(i), the deduction is confined to profits and gains of business attributable to carrying on the business of banking or providing credit facilities to its members.

14. He further contended that the interest income earned is not from the members but from the deposits placed with a third-party bank, which is not a co-operative society or cooperative bank and such income does not qualify for deduction under Section 80P(2)(a)(i). Under Section 14 of the IT Act, income must be classified under specific heads; income not falling under “Profits and Gains of Business” is taxable under the head

“Income from Other Sources” and Section 56(1) clearly provides that income not chargeable under any other specific head shall be taxed as “Income from Other Sources.”

15. The Hon’ble Supreme Court in **Totgars Co-operative Sale Society Limited** case held that interest earned on surplus funds invested in deposits, not immediately required for business purposes, is taxable under “Income from Other Sources.” The principle laid down in **Totgars Co-operative Sale Society Limited** applies squarely, as the interest income in the present case arises from the investment of surplus funds and not from core lending activity and allowing such a deduction would defeat the statutory scheme and permit co-operative societies to divert funds into unrelated investments while claiming blanket exemption. The Court acknowledged the findings of the Assessing Officer and the Appellate Authorities, who rightly held that interest earned from a non-co-operative bank is ineligible for deduction under Section 80P(2)(a)(i) or Section 80P(2)(d) and finally prayed to dismiss the appeal.

16. The learned Senior Standing Counsel for the respondent has relied upon the Hon'ble Supreme Court judgment in **The Citizens Co-operative Society Limited vs. Assistant Commissioner of Income Tax**³.

17. Having heard the rival contentions of both the parties and also material placed on record, it is undisputed that the appellant is a registered co-operative credit society engaged in providing credit facilities to its members and the dispute is whether the appellant's society is entitled for the deduction of the income accrued from deposits in a development co-operative bank and whether the income arrived can be said to be out of the business or income attributable to the nature of the business and derived from the business.

18. Admittedly, the surplus funds deposited in banks represent the appellant's own funds generated from its business operations. The case of the appellant is that the appellant being a co-operative society is entitled to claim deduction under Section 80P(2)(a)(i) of the IT Act.

³(C.A.No.10245 of 2017)

19. The Bench while dealing with the similar set of facts by this same Bench in ***M/s. SBI Staff Mutually Aided Co-operative Credit Society Ltd. v. Assistant Commissioner Income Tax***⁴, referred to the case of ***Vavveru Co-operative Rural Bank Limited v. Chief Commissioner of Income Tax***⁵ and also referred to the case of ***Commissioner of Income Tax V. Andhra Pradesh State Co-operative Bank Limited***⁶, has allowed the appeal by directing the respondent to allow the assessee/petitioner herein to claim deduction under Section 80P(2)(a)(i) of the Income Tax Act, 1961 for the assessment year 2004-2005 from the interest earned through State Bank of India and National Savings Certificates. The Division Bench of the then High Court of Andhra Pradesh held that under Section 80P(2)(d) thereof, it is only the income by way of interest or dividends derived by a co-operative society from its investments with any other co-operative society which is required to be deducted while computing the total income of the assessee. On perusal of the above said judgments, which has become finality

⁴ ITTA No.292 of 2010

⁵ (2017) 396 ITR 371 (T&AP)

⁶ (2011) 12 taxmann.com 66 (AP)

and by applying the same principles, since the facts and circumstances are similar, the said judgments are binding on the Assessing Officer and need to be followed. The respondent by taking a different view and passing a contradictory order in ITA No.1187/Hyd/2007 dated 25.04.2008; *prima facie* appears to be illegal.

20. The court also considered the judgment of the High Court of Gujarat in ***State Bank of India vs. Commissioner of Income Tax***⁷. Further, the judgment of the Hon'ble Supreme Court was relied upon by the learned Senior Standing Counsel in ***The Citizens Co-operative Society Limited vs. Assistant Commissioner of Income Tax***⁸, wherein the relevant paragraphs are extracted below:

We may mention at the outset that there cannot be any dispute to 16 the proposition that Section 80P of the Act is a benevolent provision which is enacted by the Parliament in order to encourage and promote growth of co-operative sector in the economic life of the country. It was done pursuant to declared policy of the Government. Therefore, such a provision has to be read liberally, reasonably and in favour of the assessee (See – Bajaj Tempo Limited, Bombay v. Commissioner of Income Tax, Bombay City-III, Bombay. It is also

⁷(2016) 72 taxmann.com

⁸ C.A.No.10245 of 2017

trite that such a provision has to be construed as to effectuate the object of the Legislature and not to defeat it (See – Commissioner of Income Tax, Bombay & Ors. v. Mahindra and Mahindra Limited & Ors.4). Therefore, it hardly needs to be emphasised that all those co-operative societies which fall within the purview of Section 80P of the Act are entitled to deduction in respect of any income referred to in sub-section (2) thereof. Clause (a) of sub-section (2) gives exemption of whole of the amount of profits and gains of business attributable to anyone or more of such activities which are mentioned in sub-section (2).

Since we are concerned here with sub-section (i) of clause (a) of sub-section (2), it recognises two kinds of co-operative societies, namely: (i) those carrying on the business of banking and; (ii) those providing credit facilities to its members.

In the case of Kerala State Cooperative Marketing Federation Limited & Ors. v. Commissioner of Income Tax, this Court, while dealing with classes of societies covered by Section 80P of the Act, held as follows:

6. The classes of societies covered by Section 80-P of the Act are as follows:

(a) Engaged in business of banking and providing credit facilities to its members;

XX XX XX

7. We may notice that the provision is introduced with a view to encouraging and promoting growth of cooperative sector in the economic life of the country and in pursuance of the declared policy of the Government. The correct way of reading the different heads of exemption enumerated in the section would be to treat each as a separate and distinct head of exemption. Whenever a question arises as to whether any particular category of an income of a cooperative society is exempt from tax what has to be seen is whether income fell within any of the several heads of exemption. If it fell within any one head of exemption, it would be free from tax notwithstanding that the conditions of another head of exemption are not satisfied and such income is not free from tax under that head of exemption..."

Undoubtedly, if one has to go by the aforesaid definition of 'co-operative bank', the appellant does not get covered thereby. It is

also a matter of common knowledge that in order to do the business of a co-operative bank, it is imperative to have a licence from the Reserve Bank of India, which the appellant does not possess. Not only this, as noticed above, the Reserve Bank of India has itself clarified that the business of the appellant does not amount to that of a co-operative bank. The appellant, therefore, would not come within the mischief of sub-section (4) of Section 80P.

So far so good. However, it is significant to point out that the main reason for disentitling the appellant from getting the deduction provided under Section 80P of the Act is not sub-section (4) thereof. What has been noticed by the Assessing Officer, after discussing in detail the activities of the appellant, is that the activities of the appellant are in violations of the provisions of the MACSA under which it is formed. It is pointed out by the Assessing Officer that the assessee is catering to two distinct categories of people. The first category is that of resident members or ordinary members. There may not be any difficulty as far as this category is concerned. However, the assessee had carved out another category of 'nominal members'. These are those members who are making deposits with the assessee for the purpose of obtaining loans, etc. and, in fact, they are not members in real sense. Most of the business of the appellant was with this second category of persons who have been giving deposits which are kept in Fixed Deposits with a motive to earn maximum returns. A portion of these deposits is utilised to advance gold loans, etc. to the members of the first category. It is found, as a matter of fact, that the depositors and borrowers are quiet distinct. In reality, such activity of the appellant is that of finance business and cannot be termed as co-operative society. It is also found that the appellant is engaged in the activity of granting loans to general public as well. All this is done without any approval from the Registrar of the Societies. With indulgence in such kind of activity by the appellant, it is remarked by the Assessing Officer that the activity of the appellant is in violation of the Co-operative Societies Act. Moreover, it is a co-operative credit society which is not entitled to deduction under Section 80P(2)(a)(i) of the Act.

21. The said judgment of the Hon'ble Supreme Court is distinguishable on the ground that the facts therein involved an appellant engaged in the activity of granting loans to the general public. Although, this was done without the approval of the Registrar of Societies, the activity of the appellant therein was characterized as a finance business. Consequently, they could not be termed a co-operative society because the principle of mutuality was missing in that case.

22. In the present case, there was a finding that the appellant could not be treated as a co-operative society providing credit facilities exclusively to its members. As such, the Hon'ble Supreme Court held that the society in that instance could not claim the benefit of Section 80P of the Act and with due respect, that judgment is not applicable to the present set of facts and does not come to the rescue of the respondent.

23. Learned counsel for the respondent submitted that Section 80P was interpreted in ***Vavveru Co-operative Rural Bank Limited v. Chief Commissioner of Income Tax*** (5th cited

supra), which has dealt with in detail, the tabular form is extracted below for the sake of better appreciation.

<i>Category of co-op. societies covered by sub-clauses (a) to (f)</i>	<i>Nature and extent of benefit available</i>
<p>(a)</p> <ol style="list-style-type: none"> 1) Co-operative society carrying on the business of banking or providing credit facilities to its members; 2) Co-op. society engaged in cottage industry; 3) Co-operative society engaged in marketing of agricultural produce grown by its members. 4) Co-operative society engaged in purchase of agricultural implements, seeds etc., for the purpose of supplying to its members; 5) Co-operative society engaged in processing of agricultural produce of its members without the aid of power. 6) Co-operative society engaged in collective disposal of the labour of its members. 7) Co-operative society engaged in fishing or allied activities. 	<p>The whole of the amount of profits and gains of business attributable to any one or more of such activities.</p>
<p>(b)</p> <p>Primary co-operative society engaged in supplying milk, oil seeds, fruits or vegetables grown by its members to-</p> <ol style="list-style-type: none"> 1) A federal co-operative society, engaged in the same business; 2) The government or a local authority; 3) The government company or corporation engaged in the same business; 	<p>The whole of the amount of profits and gains on such business.</p>
<p>(c)</p> <ol style="list-style-type: none"> 1) A consumer co-operative society engaged in activities other than those specified in clause (a) or clause (b) either independently of, or in addition to, all or any of the activities so specified. 	<p>So much of the profits and gains attributable to such activities not exceeding Rs. 100,000 (one hundred thousand rupees).</p>
<ol style="list-style-type: none"> 2) Co-operative society other than a consumer co-operative society engaged in activities other than those specified in clauses (a) and (b). 	<p>So much of the profits and gains attributable to such activities not exceeding Rs. 50,000 (fifty thousand rupees)</p>

(d) Interest or dividends derived by the co-operative society from its investments with any other co-operative society;	The whole of such income.
(e) Any income derived by the co-operative society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities;	The whole of such income.
(f) A co-operative society other than <ol style="list-style-type: none"> 1) A housing society; 2) An urban consumer society; 3) A society carrying on transport business; 4) A society engaged in the performance of any manufacturing operations with the aid of power, where the gross total income does not exceed Rs. 20,000 (twenty thousand rupees). 	The income by way of interest on securities and the income from house property chargeable under section 22.

24. The appellant contended that its society falls within Section 80P(2)(a), which pertains to a co-operative society carrying on the business of banking or providing credit facilities to its members. The very nomenclature of the appellant's society is "The Ismailia Co-operative Credit Society Limited" and regarding the nature of the activities, while the appellant is not carrying on banking activities, but admittedly providing credit to its members out of the income and interest yielded from bank deposits kept for safe custody.

25. It is settled law that if a society makes any profit or gain from business attributable to such activity, then such income qualifies for deduction under Section 80P(2)(a)(i) and the

judgment of the Andhra Pradesh High Court in **Anakapalli Co-operative Marketing Society Limitedv. CIT**⁹ has held that to claim the deduction under Section 80P(2)(a)(i), providing credit facilities must be one of the assessee's activities and the income must be towards profits or gains therefrom. It is also the case of the appellant that the amounts received by the appellant's society are kept in the bank for the purpose of earnings interest thereon.

26. The learned Senior Standing Counsel for the respondent pointed out that the society would fall under Section 80P(2)(c) and Section 80P(2)(d) based on the tabular form presented earlier. However, upon perusal of that section, it applies to any co-operative society other than consumer co-operative societies engaged in activities other than those specified in clause (a) and clause (b). Section 80P(2)(c) is not applicable to the present set of facts as it relates to co-operative societies in general and does not apply to a co-operative society providing credit. Since clause (a)(i) specifically covers cooperative societies providing credit

⁹ 2000 (245 ITR 616)

facilities, the contention of the learned Senior Standing Counsel cannot be accepted, for the reason that the said provision is only applicable to cooperative societies that do not fall under categories (a) and (b) and it is only in respect of the co-operative societies other than categories (a) and (b).

27. It is clear that eligibility for deduction under Section 80P(2)(a) requires that the claim must relate to the profits and gains of business attributable to one or more of the activities specified therein. In the present case, the appellant is a co-operative society providing credit facilities, which falls directly under the specified activities. Consequently, the appellant is entitled to claim the deduction under Section 80P(2)(a) of the IT Act.

28. This Bench is of the considered view that the findings given by the Assessing Officer, the Commissioner and the Appellate Tribunal do not hold good and that the appellant is *prima facie* entitled to the deduction under Section 80P(2)(a) of Income Tax Act. Accordingly, the substantial question of law is answered in favour of the appellant and against the respondent.

29. With the aforementioned reasons, the appeal is allowed setting aside the orders passed by the Income Tax Appellate Tribunal (ITAT), the Commissioner of Income Tax (Appeals) and the Assessing Officer, Hyderabad Bench 'A' in I.T.A.No.1187/Hyd/2007 (assessment year 2004-05) dated 25.04.2008. The respondents are directed to reconsider the case of the appellant for the deduction of their income earned by way of interest accrued from deposits kept in the bank and pass appropriate orders within a period of three (3) months from the date of receipt of a copy of this order by giving a fair opportunity of hearing to the appellant and communicate the same to the appellant. There shall be no order as to costs.

As a sequel, miscellaneous applications, if any pending, shall stand closed.

JUSTICE P. SAM KOSHY

JUSTICE NARSING RAO NANDIKONDA

Date: 26.03.2026.

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