IN THE INCOME TAX APPELLATE TRIBUNAL
BANGALORE BENCHES "B", BANGALORE

Before Shri Chandra Poojari, AM & Shri George George K, JM ITA

No.603/Bang/2014 : Asst.Year 2010-2011

M/s.Vijaya Bank Employees Housing Co-operative Society Ltd. #999A, 1st Floor, Vijaya Bank Layout, MSRS Nagar, Bilekahalli Bangalore – 560 076. PAN : AAAJV0301M.	**v.**	**The Asst.Commissioner of Income-tax, Circle 10(1) Bangalore.**
(Appellant)		**(Respondent)**

Appellant by : Sri.V.Chandrashekhar, Advocate
Respondent by :Shri Priyadarshi Mishtra, Addl.CIT-DR

Date of Hearing : 15.07.2021	**Date of Pronouncement : 15.07.2021**

ORDER

Per George George K, JM

This appeal at the instance of the assessee is directed against CIT(A)'s order dated 21.01.2014. The relevant assessment year is 2010-2011.

2. Thirteen grounds are raised in this appeal. Ground Nos.1, 12 and 13 are general in nature and no adjudication is required. Ground Nos.3 and 4 are not pressed by the learned AR during the course of hearing, hence, the same are dismissed. The surviving grounds are Ground Nos.2, 5 to 11.

3. Brief facts of the case are as follow:

The assessee is a housing co-operative society formed in the year 1974 for the purpose of meeting housing needs of the employees of Vijaya Bank. All the members of the assessee-society are either present or ex-employees of Vijaya Bank. The activities of assessee-society is to acquire land and develop

the same into sites and allot them to its members at a reasonable price. The underlying idea being that collective buying in large scale would enable better price negotiations and also do away with intermediaries in purchasing the land and developing them into sites.

4. The assessee for the assessment year 2010-2011, filed the return of income on 13.10.2010 declaring excess of income over expenditure at Rs.21,57,631. The assessee's case was selected for scrutiny by issuance of notice u/s 143(2) of the I.T.Act. The Assessing Officer during the course of assessment proceedings, noted that the assessee was in receipt of interest income from bank of Rs.5,78,37,690 and also the assessee had claimed expenditure of interest paid on sites deposits of Rs.4,75,00,000. The assessee was asked to explain the above transactions. The assessee submitted submissions on 30.11.2012 and also on 23.02.2013. The relevant portion of the submissions of the assessee are extracted in the assessment order. The assessee submitted that the interest income was shown as income in the books of account of the assessee-society and substantial interest was credited to the individual members account as interest against their advances and the same was claimed as expenditure. The Assessing Officer disallowed the claim of interest of Rs.4,75,00,000 by making following observations:-

(i) The relation of the bank with the assessee is that of an investor and banker, other than that there is no special relationship the bank had with the assessee society.

(ii) The assessee has claimed only part of the interest as exempt and part is offered for tax.

(iii) The assessee's claim of mutuality concept in respect of interest receipt from bank cannot be accepted in view of the Supreme Court's decision in the case of Bangalore Club and will therefore be exigible to income tax in the hands of the assessee.

4.1 The Assessing Officer also disallowed certain expenditure stating the same to be capital expenditure.

5. Aggrieved by the order of the Assessing Officer, the assessee preferred an appeal to the first appellate authority. Before the first appellate authority, it was submitted that – (i) interest expenditure claimed is purely compensatory to offset cost overrun, and (ii) based on principle of matching concept the expenditure attributable to income shall be allowed. In this context the assessee relied on the judgment of the Hon'ble Apex Court in the case of J.K.Industries v. UOI reported in 297 ITR 176 (SC).

5.1 The CIT(A) proposed to tax the entire interest income earned from bank by holding that the assessee is a mutual society and that non-mutual income is to be taxed in its entirety. This had the effect of enhancing the assessed income and a notice u/s 251(2) of the I.T.Act was issued vide order sheet entry dated 19.12.2013. The assessee in response to the enhancement proposed, submitted as follows:-

(i) The assessee is consistently filing the return of income just like any other undertaking engaged in commercial venture and is not claiming exemption on the income earned by it under mutuality concept and offering the income under the head `Income from profits and gains of business'.

(ii) The CIT(A) does not have the requisite powers under section 251 of the I.T.Act to assess an income under a different head of income other than the one under which it has been assessed.

(iii) Interest paid on deposits to members is a charge on interest income earned from banking the same with banks as fixed deposits.

(iv) Even if the interest income is considered as Income from Other Sources, interest paid is ought to be allowed under section 57(ii) of the I.T.Act as expenses laid out or expended wholly and exclusively for the making or earning of the said interest income.

5.2 The CIT(A) rejected the objections raised by the assessee and passed an order by enhancing the assessed income to Rs.5,79,75,310. The reasoning of the CIT(A) are summarised as follows :-

(i) The Commissioner (A) has the jurisdiction to examine all matters including those which are not subject matter of appeal by placing reliance on

M.Loganathan v. ITO 350 ITR 373 (Mad. HC) and CIT v. K.S.Dattatreya 344 ITR 127 (Kar HC).

(ii) The assessee-co-operative society is essentially a mutual benefit society with close identity of contributors and beneficiaries. It could not do business with itself. It could not profit from the activities which are only for benefit of the members. Therefore, the income of the assessee is not taxable under the head `Income from profits and gains of business' but under the head of `income from other sources'. Further, entire interest income is taxable without any deduction.

(iii) The interest paid to members on the site deposit is not allowable business expenditure as there is no contractual obligation when amounts were received from members. There is no mandate on society for financial assistance or welfare of its members. The assessee has not given any details of rate of interest, etc. and how a lump-sum amount of Rs.4.75 crore was determined. There is no substance in claim of the assessee that the interest was paid / payable as account summary of member contributors does not show such credit accruing on their balances, at best it is only an accounting entry. Advances given by members are not deposits in true sense but only a contribution.

6. Aggrieved by the order of the CIT(A), the assessee has preferred this appeal before the Tribunal. Both the AR and DR submitted the following issues arise for our consideration.

(i) Whether the Commissioner (Appeals) is justified in law in holding that the assessee is a mutual benefit society and thrusting the provisions of mutuality principle even when the assessee never claimed the benefit of mutuality principle?

(ii) Whether the Commissioner (Appeals) is justified in upholding the disallowance of the interest expenditure and other expenditure in the facts and circumstances of the case?

(iii) Whether the Commissioner (Appeals) is justified in not allowing deduction of interest expenditure under section 57(iii) of the Act as expenses laid out or expended wholly and exclusively for the making or earning of the said interest income in the event of holding the interest income as `income from other sources'?

(iv) Whether the Commissioner (Appeals) is right in confirming disallowance of Rs.37,00,941 made by the A.O. stating that the same is a capital expenditure ?

7. The learned AR submitted that out of the above four issues, three issues are covered in favour of the assessee by the order of the Tribunal in assessee's own case for assessment years 2007-2008 to 2009-2010 and 2011-2012 to 2014-2015 in ITA No.766 to 772/Bang/2018 (order dated 01.04.2021).

8. The learned Departmental Representative, on the other hand, strongly supported the order of the CIT(A).

9. We have heard rival submissions and perused the material on record. Out of the above four issues mentioned in the preceding para 6, three issues are covered by the order of the Tribunal in assessee's own case for assessment years 2007-2008 to 2009-2010 and 2011-2012 to 2014-2015 (supra). The relevant finding of the Tribunal in asessee's own case reads as follow:-

> **"12. We have heard rival submissions and perused the material on record. To understand the dispute raised, it is necessary to elaborate the facts a little more. As mentioned earlier, the assessee is a housing co-operative society, incorporated in the year 1974 for the purpose of meeting housing needs of the employees of Vijaya Bank. All the members of the society are either present or ex-employees of Vijay Bank. The activities of the assessee-society is to acquire land, convert it into residential sites by developing infrastructure such as roads, streetlights, providing water supply, drainage and allot the same to its members on a no profit no loss basis. The assessee had undertaken a project for creation of layouts at Bangalore-Mysore High Court in the year 2005. At the time of starting of the project, the members of the assessee-society were informed that the site shall be handed over to them within a period of 12 months. As there was delay in implementation of the project, the unutilized funds or idle funds from out of advances collected towards allotment of sites from members were deposited in fixed deposits. The interest earned from the same was offered to tax by the assessee. Therefore, there is no dispute with regard to the taxability of the interest income earned.**
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> **12.1 However, since the project was delayed for more than one year, the members expressed anxiety that advances paid by them which are yet to be spent on the project is utilized by the assessee in making FD's and earning interest. Therefore, the members stated that interest earned should be rightfully belonging to the members. The members unanimously opined that they need to be compensated on account of delay in implementation of project failing which they may be forced to withdraw from the project and demand refund of advance paid to the assessee-society. At that juncture, one of the Directors of Vijay Bank, who is also member of the assessee-**

society, intervened stating that if members start withdrawing from the project, the same have to be abandoned midway and recovery of payments made so far to the landlord and the developers would become very difficult. Accordingly, he suggested to the members to accept compensation instead of resorting to the withdrawals from the project. It was also stated that the compensation cannot exceed the interest earned from bank on advances received from the members. Accordingly, resolution was passed in the Annual General Meeting of the assessee-society held on 30.09.2007, which reads as follow:-

"Resolved that interest be paid to the members annually, by way of compensation, proportionate on the advance made by them, on the basis of interest earned during each such year.

Further resolved that the interest be credited to a separate account called interest payment to members every year and the same be treated as further contribution of the members of the Society towards the project.

Certified True Copy"

12.2 A copy of certified extract of minutes of AGM of assessee society held on 30.09.2007for passing the above resolution is on record. Consequent to the above resolution, the assessee-society paid compensation out of interest earned from FD's. This payment of compensation to members has given rise to the entire dispute in question. Therefore, the only issue is regarding the payment of interest / compensation to the members whether it is allowable deduction to the assessee-society. In view of the above factual background, the order of the A.O. and CIT(A), following issue arises for our adjudication, namely, (i) whether the assessee can be thrust upon a status of a mutual society, (ii) whether the interest expenditure can be allowed as a deduction u/s 37 or u/s 36(1)(iii) of the I.T.Act, and (iii) even assuming that interest income is to be assessed as income from other sources, whether the interest expenditure can be allowed as deduction u/s 57(3) of the I.T.Act.

(i) Whether the assessee can be thrust upon the status of a mutual society:

12.3 It is an undisputed fact that the assessee did not claim any exemption under the concept of mutuality for any of its income. The returns of income have been filed for all the relevant assessment years, like any other commercial undertaking. The Assessing Officer was of the view that the assessee is a mutually benefit society and surplus, if any, from its activities with its members is exempt from tax. Further, the Assessing Officer held that non-mutual income arising from sources other than members is liable to be taxed.

Thereby the A.O. held that surplus as reflected in the income and expenditure account is to be ignored and gross income of the interest are liable to taxed. We are of the view that the A.O. cannot on his own decide to grant the benefit of mutuality when it is not claimed by the assessee. The Assessing Officer's cannot force the assessee to follow a method detrimental to the assessee, more so, when alternative method is not prohibited by law. In the facts of the given case the assessee is not entitled to claim the status of mutual society because there is taint of commerciality in the activities, which we shall discuss in the succeeding paragraphs. The Hon'ble Apex Court in the case of Kumbakonam Mutual Benefit Fund Limited reported in AIR 1965 SC 96, denied the exemption of mutuality because of taint of commerciality by holding as follows:-

"A shareholder in the assessee-company is entitled to participate in the profits without contributing to the funds of the company by taking loans. He is entitled to receive dividend as long as he holds a share. He has not to fulfill any other condition. His position is in no way different from that from a shareholder of a banking company limited by shares. Indeed, the position of the assessee no different from an ordinary bank except that it lends money to and receives deposits from its shareholders. This does not by itself make its income any the less income from business within section 10 of the Indian Income Tax Act."

12.4 In the instant case, the members even after obtaining site / plot from assessee-society once, is entitled to continue to retain his membership. Therefore, there is no contribution from his side though he is entitled to participate in the profits earned by the assessee-society, which can be distributed in the form of dividend. The very fact that bylaws of the assessee-society contained the provisions that payment of dividend to its members goes to show that it is not a mutual society and commerciality is very much inherent in the activities of the assessee-society. In this regard, clause 75(6) of the Byelaws of the assessee-society is relevant. Therefore, the action of the Assessing Officer in thrusting the concept of mutuality even when the assessee-society never claimed the concept of mutuality, is bad in law and is hereby set aside.

(ii) <u>Whether the interest expenditure can be allowed as a deduction u/s 37 or u/s 36(1)(iii) of the I.T.Act.</u>

12.5 The interest expenditure claimed by the assessee is purely compensatory to offset cost overrun to the members of the assessee-society. Therefore, based on the principle of matching concept, the expenditure attributable to income ought to be allowed. In this regard reliance is placed on the judgment of the Hon'ble Apex Court in the case of

J.K.Industries v. UOI reported on 297 ITR 176 (SC), wherein the Hon'ble Supreme Court had held as follows:-

"The object of incurring expenses is to produce revenue. In measuring the income for a period, revenue is to be adjusted against expenses incurred for producing that revenue. This concept of adjusting / offsetting the expenses against revenue is the matching principle."

12.6 The above proposition further draws strength from the judgment of the Hon'ble Apex Court in the case of CIT v. Lakshmi Machine Works reported in 290 ITR 667 (SC), wherein the Hon'ble Supreme Court had held as follows:-

"The tax under the Act is upon income, profits and gains. It is not a tax on gross receipts. Under section 2(24) the word `income' includes profits and gains. The charge is not on gross receipts but on profits and gains properly so-called. Gross receipts or sale proceeds, however, include profits. However, subject to special requirements of the income tax, profits have got to be assessed provided they are real profits. Such profits have to be got to be ascertained on ordinary principles of commercial trading and accounting. However, the income-tax has laid down certain rules to be applied in deciding how the tax should be assessed and even if the result is to tax as profits what cannot be construed as profits, still the requirements of the income-tax must be complied with. Where a deduction is necessary in order to ascertain the profits and gains, such deductions should be allowed. Profits should be computed after deducting the expenses incurred for business though such expenses may not be admissible expressly under the Act, unless such expenses are expressly disallowed by the Act."

12.7 Further, the Income Tax Authorities failed to appreciate that the money contributed by the members was invested in FD's and the portion of the interest earned thereon was credited to the account of the members way of compensation for delay in allotment of sites to the members. Therefore, the interest paid on advances from members is chargeable on interest income earned from depositing the same with the bank by the assessee. In other words, there is a direct nexus between the contribution by the members, which was utilized for making fixed deposit to earn interest income and payment of portion of such interest income earned as compensation to members for delayed allotment of sites. Therefore, the interest credited to the members is wholly and exclusively for the purpose of business and entitled to deduction u/s 37(1) of the I.T.Act. For claiming expenditure u/s 37(1) of the I.T.Act, there was no need for a cause and effect relationship between an item of income and expenditure as claimed by the A.O. All that would be necessary is only that it is for the "purpose of business" and not necessary for earning of the income. In this context, reliance is placed on the judgment of the Hon'ble Apex

Court in the case of Sassoon J David & Co. Pvt. Ltd. v. CIT reported in 118 ITR 261.

Even assuming that interest income is assessed as income from other sources, whether the interest expenditure ought to be allowed as a deduction u/s 57(iii) of the I.T.Act.

12.8 As mentioned earlier, the interest paid on advances from members is chargeable on interest income earned from depositing the same with banks by the assessee because had there been no advances from members, there would not have arisen the interest income to the assessee-society. This being the situation, it necessarily follows that the interest paid / credited to the members on account of the advances is an expenditure laid out or expended wholly and exclusively for the earning of the interest income. The Hon'ble Delhi High Court in the case of CIT v. Sasan Power Limited reported in 18 taxmann.com 182 (Delhi) had held that when interest income and interest expenditure are inextricably linked and there was commonality in nature and purpose, the expenditure is allowable as deduction u/s 57(iii) of the I.T.Act. In the case of Taj International Jewellers reported in 335 ITR 144, the Hon'ble Delhi High Court had held that when there is no dispute that money obtained on loan was converted and made into fixed deposit receipts, the interest on loan was an allowable deduction against the interest income earned from fixed deposit.

12.9 The Assessing Officer has taken a view that there is no obligation on the assessee-society to pay interest to its members when advance was received. Therefore, the A.O. concluded that there is no contractual obligation to pay interest. On the other hand, we are of the view that it is not the requirement under Contract Law that all terms of the contract be agreed upon upfront and there is no scope for alteration thereafter. In the instant case, the delay in procuring the land and formation of site was unforeseen at the initial stage when advances were collected by the assessee-society. Having parted with money and also with site allotment being delayed, the expectation of the members to be compensated by way of interest on their advances is only legitimate. In view of the foregoing reasoning, we are of the view that even assuming that interest income is to be taxed under the head "income from other sources", the interest expenditure that is paid to the members of the assessee-society is to be allowed u/s 57(iii) of the I.T.Act. It is ordered accordingly.

12.10 Therefore, the grounds raised on the merits are allowed."

10. In view of the above Tribunal order in assessee's own case for assessment years 2007-2008 to 2009-2010 and 2011-2012 to 2014-2015 (supra), we hold that the assessee is entitled to the claim of deduction of interest expenditure being the amount paid to the members of the assessee-society.

11. As regards the claim of deduction amounting to Rs.37,00,941, the A.O. had disallowed the expenditure stating the same as a capital expenditure.

11.1 The learned AR fairly conceded that the expenditure enumerated above are capital in nature. In view of the submission of the learned AR, the expenditure is held to be capital in nature. Accordingly, this issue is decided against the assessee.

12. In the result, the appeal filed by the assessee is partly allowed, as indicated above.

Order pronounced on this 15th day of July, 2021.

Sd/-	Sd/-
(Chandra Poojari)	(George George K)
ACCOUNTANT MEMBER	JUDICIAL MEMBER

Bangalore; Dated : 15th July, 2021.
Devadas G*

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1. **The Appellant.**
2. **The Respondent.**
3. **The CIT(A)-V, Bangalore.**
4. **The Pr.CIT-IV, Bangalore**
5. **The DR, ITAT, Bengaluru.**
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Asst.Registrar/ITAT, Bangalore