

Bihar State Co-Operative Bank Ltd.

Vs

Commissioner of Income-Tax

Civil Appeals Nos. 228 to 230 of 1958

(J. L. Kapur, A. K. Sarkar, M. Hidayatullah)

22.02.1960

JUDGMENT

KAPUR, J. –

The appellant is a bank registered under the Co-operative Societies Act, 1912 (II of 1912), and is deemed to be registered under the Bihar & Orissa Co-operative Societies Act, 1935 (Bihar Act VI of 1935), which in Bihar has replaced the Co-operative Societies Act of 1912. It was carrying on banking business in the State of Bihar. One of the objects of the bank is to carry on general business of banking not repugnant to the provisions of the Bihar Act and rules framed thereunder for the time being in force (bye-law 3(a)(vi)). In the calendar years 1945, 1946 and 1947, the appellant bank received by way of interest on deposits with the Imperial Bank of India the sums of Rs. 7,192, Rs. 20,250 and Rs. 22,600 respectively. It is these sums which are the subject matter of dispute in these three appeals which relate to the respective assessment years 1946-47, 1947-48 and 1948-49. These sums were not assessed when assessment was made under section 23(3) of the Income-tax Act, but subsequently under section 34 they were assessed as being "income" under the head "other sources." This order was upheld by the Appellate Assistant Commissioner and by the Income-tax appellate Tribunal. A case was then stated to the High Court under section 66(1) of the Act, but was decided against the appellant. The appellant brought three appeals in this court in regard to the three assessment years. In each one of them the respondent is the Commissioner of Income-tax, Bihar and Orissa. As the appeals involve a common question of law they were consolidated and can conveniently be disposed of by one judgment.

In its return the appellant showed these various sums as "other sources," but nothing turns on the manner in which the appellant chose to show this income in its return. The Income-tax Officer, however, assessed the interest for these three years under section 12 of the Income-tax Act, as income from "other sources." The appellant took an appeal to the Appellate Assistant Commissioner where it was contended that as the business of the appellant bank consisted of lending money and the deposits had been made not for the purpose of investment but for that business and thereby fulfilling the purpose for which the co-operative bank was constituted. These various sums of interest were not subject to income-tax because of the notification issued by the Central Government under section 60 of the Income-tax Act. The relevant portion of that notification, C.B.R. Notification No. 35 dated October 20, 1934, and No. 33 dated August 18, 1946, was :

"The following classes of income shall be exempt from the tax payable under the said Act, but shall be taken into account in determining the total income of an assessee for the purposes of the said Act :...

(2) The profits of any co-operative society other than the Sanikatta Salt Owners' Society in the Bombay Presidency for the time being registered under the Co-operative Societies Act, 1912 (Act II of 1912), the Bombay Co-operative Societies Act, 1925 (Bombay Act VII of 1925), or the Madras Co-operative Societies Act, 1932 (Madras Act VI of 1932), or the dividends or other payments received by the members of any such society out of such profits.

Explanation. - For this purpose the profits of a co-operative society shall not be deemed to include any income, profits or gains from :

(1) investments in (a) securities of the nature referred to in section 8 of the Indian Income-tax Act, or (b) property of the nature referred to in section 9 of that Act,

(2) dividends, or

(3) the 'other sources' referred to in section 12 of the Indian income-tax Act."

The Appellate Assistant Commissioner, however, repelled the contention of the appellant. He held that the business of the appellant consisted of "lending money, and selling agricultural and other products to its constituents" which could be planned ahead and required no provision for extraordinary claims. He remarked that it appeared from the

balance-sheets that in the accounting year 1946 the bank invested Rs. 13,50,000 as fixed deposits, which, in the following year was raised to Rs. 15,00,000 and it was only in the accounting year 1947 that the fixed deposits "were realised on maturity with interest." He was also of the opinion that the length of the period during which this money "was kept locked in this was "showed clearly that" not the exigencies of pressing necessities, but the motives of investment of surplus fund had actuated the deposits." He therefore held that the fixed deposits with the Imperial Bank were held as an investment quite apart from the business of the appellant and the interest from these deposits was not exempt from income-tax. He further held that the exemption as to the profit of a co-operative society extended to its sphere of co-operative activities and, therefore, interest from investments was no part of the appellant's business profits exempt from taxation. Against this order an appeal was taken to the Income-tax Appellate Tribunal and it was there contended that the bank did not make the deposits as investments, but in order that cash might be available to the appellant "continuously" for the carrying on of the purposes of its business, and that the deposits were intimately; connected with the business of the appellant and therefore the interest should have been held to be profits arising from the business activities of the bank, and that the finding that the short-term deposits in the Imperial Bank were separate from the appellant's banking business was erroneous. The Income-tax Appellate Tribunal, by its order dated April 11, 1955, held :

"(1) That the interest was an income rightly to be included under the head of 'other sources....'

(2) The profits of a co-operative society indicates the profit derived from the business which can be truly called the business of the co-operative society. Investments by the society either in securities or in shares or in bank fixed deposits are made out of surplus funds. The interest or dividend derived from such investment cannot be regarded as part of the profits of the business (sic) qua such bank and, therefore, it is not exempt from income-tax (Vide Hoshiarpur Central Co-operative Bank v.

Commissioner of Income-tax)."

Against this order a case was stated at the instance of the appellant under section 66(1) of the Act, and the following two questions of law were referred for the opinion of the High Court :

(1) Whether, in the facts and circumstance of this case, the receipt of interest on fixed deposits was an income under the head of "other sources"; and

(2) Whether in the facts and circumstances of this case, the receipt of interest from the fixed deposits was an income not exempt from taxation under the C.B.R. Notification No. 35 dated October 20, 1934, and No. 33 dated the August 18, 1945.

In the High Court the appellant's contention was that the fixed deposits were made with the Imperial Bank of India not with the idea of making investments, but for the reason that cash should be available to the appellant as and when it was needed for the purposes of its business. It was also contended that the deposits were short-term deposits and that the bank could not carry on its business without such short-term deposits. In other words, the contention was that making deposits with the Imperial Bank was intimately connected with the business activities of the appellant bank and that the interest received on the deposits was profit attributable to its business activities. But the High Court did not accept this contention. It held that if the income derived by a

co-operative society was from the business of the co-operative society as such, it fell within the exemption, but if it arose out of the business with third parties as in the case of investment of surplus assets, the exemption was inapplicable because the investment of fluid assets was not a part of the business of the co-operative bank and the reason for the notification was to exempt profits accruing to a co-operative society from "carrying on business of a mutual co-operative society and upon the ground that a man cannot make profit or loss out of himself".

The ground of mutuality was not relied upon before us by the learned Solicitor-General who appeared for the respondent. So the sole question for determination is whether the investment by a co-operative bank of its assets in fixed deposits in the manner that the appellant bank had deposited its moneys falls within the term "business" and is therefore assessable under section 10 of the Income-tax Act, or it is an investment the interest from which would fall under the term "other sources" and therefore within section 12 of the Income-tax Act. It was contended by the learned Solicitor-General that the finding of the Appellate Tribunal as to the nature of these deposits was one of fact. This contention is not sustainable. It has not been treated as a finding of fact either by the Appellate Tribunal or by the High Court. They have both treated it as a question of law and it is on that basis that the reference was made. The decision of the question depends on what is comprised within the ordinary business of a bank and whether the business of the appellant bank is in any way different.

Relying upon the decision of a Privy Council in *Punjab Co-operative Bank Ltd. v. Commissioner of Income-tax*, counsel for the appellant submitted that the business of a bank is one of dealing in money and credit and that laying out moneys in deposit with other banks is just as much a mode of conducting business as lending moneys to borrowers whether members of the society or to other co-operative societies, and is therefore a part of the appellant's business. Therefore, where out of moneys in deposit with a bank a portion is put away or laid out in securities or in deposits with another banker, two objects are served : (1) the moneys which are not immediately required do not remain idle but earn interest; and (2) if and when money is required to meet any demand, the

investment, i.e., the deposits as well as the securities, provide a source from which these requirements can easily be met. Thus the credit of the bank remains unimpaired and its moneys continue to earn interest.

Counsel for the respondent argued that where moneys are so laid out they cannot be termed "carrying on business of the bank" and therefore any sums coming in from such investments cannot be termed profits arising from business, but they are income from "other sources". In support of this argument reliance was placed by counsel on Commissioner of Income-tax v. Madras Central Urban Bank Ltd.; Madras provincial Co-operative Bank Ltd. v. Commissioner of Income-tax; Commissioner of Income-tax v. Bengalee Urban Co-operative Credit Society Ltd.; Commissioner of Income-tax v. Madras Provincial Co-operative Bank Ltd.; Hoshiarpur Central Co-operative Bank Ltd. v. Commissioner of Income-tax; Cochin Cottage Industries Co-operative Marketing Society Ltd. v. Commissioner of Income-tax. But none of these cases supports the argument raised on behalf of the respondent. In the Madras Central Urban Bank case, the society was required to invest 40 per cent. of its total liability under call deposits in a liquid or fluid form and the society invested it in Government securities which produced interest. It was held that interest from securities was not part of the profits of the business of the society as it was not obliged to invest in such securities. Similarly in the Madras provincial Co-operative Bank case, also the income which was the subject matter of dispute was interest received by the bank from its investments in Government securities and it was held that it was not part of the income derived from its business. The Rangoon case, Commissioner of Income-tax v. Bengalee Urban Co-operative Credit Society, was also a case relating to income derived from interest on capital invested in Government securities. At page 128, Page, C.J., said :

"... and prima facie therefore neither interest from securities nor income derived from property are 'profits' within the meaning of that term as used in the notification... It may be that the investment of capital in properties or securities is part of the business of an assessee, and in such a case, in my opinion, the net income accruing from such investments would be, and be chargeable as profits of the business."

(As the matter had not been considered from this point of view the case was sent back for doing so.)

These cases before the amendment of the notification show that the income which was exempted was profit from business and not income from sources which fell under section 8 and 9 of the Income-tax Act. Commissioner of Income-tax v. Madras Provincial Co-operative Bank Ltd. was a case where moneys had been invested in debentures and for reasons similar to the ones given in the cases abovementioned, it was held that interest derived therefrom was not profits of the business.

Counsel for the respondent relied on a judgment of the Punjab High Court in Hoshiarpur Central Co-operative Bank v. Commissioner of Income-tax. In that case the Government authorised the bank to deal in sugar, oil and standard cloth and it made profit therefrom. Those activities were neither its business under the bye-laws nor within its objects. The question was whether this profit was exempt from income-tax on account of its being profits of a co-operative society and it was held that the decided cases showed that where income was derived by a co-operative society, the profits were within the exemption, but not if the business was of the nature not covered by the objects of the society. This line of reasoning has not formed part of the respondent's argument in this court and the case therefore has no application to the facts of the present case. The decision in Cochin Cottage Industries Co-operative Marketing Society Ltd. v. Commissioner of Income-tax,

proceeded on the same ground. In that case the profit which was held not to be exempt under the notification was the apportioned profit of the society from its dealings with non-members.

In *Surat Peoples' Co-operative Bank Ltd. v. Commissioner of Income-tax*, the profit arose during the course of banking business out of the sale of Government securities which formed part of the stock-in-trade and as it was a co-operative bank the profits made from such sales were held to be exempt from taxation under the notification.

In the instant case the co-operative society (the appellant is a bank. One of its objects is to carry on the general business of banking. Like other banks money is its stock-in-trade or circulating capital and its normal business is to deal in money and credit. It cannot be said that the business of such a bank consists only in receiving deposits and lending money to its members or such other societies as are mentioned in the objects and that when it lays out its moneys so that they may be readily available to meet the demand of its depositors if and when they arise, it is not a legitimate mode of carrying on of its banking business. The Privy Council in *Punjab Co-operative Bank Ltd. v. Commissioner of Income-tax*, where the profits arose from the sale of Government securities, pointed out at page 645 that in the ordinary cases the business of a bank essentially consists of dealing with money and credit. Depositors put their money in the bank at a small rate of interest and in order to meet their demands if and when they arise the bank has always to keep sufficient cash or easily realisable securities. That is a normal step in the carrying on of the banking business. In other words "that is an act done in what is truly the carrying on or carrying out of a business". It may be added that another mode of conducting the business of a bank is to place its funds in deposit with other banks and that also is to meet demands which may be made on it. It was however argued that in the instant case the moneys had been deposited with the Imperial Bank on long term deposits inasmuch as they were deposited for one year and were renewed from time to time also for a year; but as is shown by the accounts these deposits fell due at short intervals and would have been available to the appellant had any need arisen.

Stress was laid on the use of the word "surplus" both by the Tribunal as well as by the High court and it was also contended before us that in the bye-law under the heading "business of the bank" it was provided that the bank could "invest surplus funds when not required for the business of the bank in one or more ways specified in section 19 of the Bihar Act (clause 4 III(i) of the bye-laws). Whether funds invested as provided in section 19 of the Bihar Act would be surplus or not does not arise for decision in this case, but it has not been shown that the moneys which were in deposit with other banks were "surplus" within that bye-law so as to take it out of banking business. As we have pointed out above, it is a normal mode of carrying on banking business to invest moneys in a manner that they are readily available and that is just as much a part of the mode of conducting a bank's business as receiving deposits or lending moneys or discounting hundies or issuing demand drafts. That is how the circulating capital is employed and that is the normal course of business of a bank. The moneys laid out, in the form of deposits as in the instant case would not cease to be a part of the circulating capital of the appellant nor would they cease to form part of its banking business. The returns flowing from them would form part of its profits from its business. In a commercial sense the directors of the company owe it to the bank to make investments which earn them interest instead of letting moneys lie idle. It cannot be said that the funds of the bank which were not lent to borrowers but were laid out in the form of deposits in another bank to add to the profit instead of lying idle necessarily ceased to be a part of the stock-in-trade of the bank, or that the interest arising therefrom did not form part of its business profits. Under the bye-laws one of the objects of the appellant bank is to carry on the general business of banking and therefore, subject to the Co-operative Societies Act, it has to carry on its business in the manner that ordinary banks do. It may

be added that the various head under section 6 of the Income-tax Act and the provisions of that Act applicable to these various head are mutually exclusive. Section 12 is a residuary section and does not come into operation until the preceding heads are excluded. Commissioner of Income-tax v. Basant Rai Takhat Singh.

In our opinion, the High Court was in error in treating interest derived from deposits as not arising from the business of the bank and therefore not falling within the income exempted under the notification. The appeal must therefore be allowed and the judgment and order of the High Court set aside. The appellant will have its costs in this court and in the court below.

Appeal allowed.

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