ANDHRA PRADESH HIGH COURT

Commissioner of Income Tax

Vs

Anakapalli Co. Op. Marketing

(Surya Rao, J.)

10.03.2000

JUDGMENT

Surya Rao, J.

1. On a reference application filed by the Commissioner, Visakhapatnam, in R.A. No. 437 (Hyd.) of 1989, in Income Tax Appeal No. 3 (Hyd.) of 1987 for the assessment year 1983-84, the Tribunal, Hyderabad Bench 'B', referred this case under section 256(1) of the Income Tax Act, 1961 Income Tax Act for the decision of this Court.
2. The factual matrix leading to the present reference may be stated thus:

2. The factual matrix leading to the present reference may be stated thus:

The Anakapalli Co-operative Marketing Society Ltd., Anakapalli, is the assessee. The assessee has been carrying on business of providing facilities to its members for obtaining fertilizers, food grains, controlled cloth, trading on commission basis, advancing loans to members on the security of their produce and leasing godown for rent besides arranging loans through the State bank of India, Anakapalli. The State bank of India has been granting loans to the members of the assessee for growing sugarcane. But the bank has been insisting on the loanees to produce certificates from the assessee certifying the details of the lands owned or cultivated by the ryots, the crop grown as seen by personal inspection, and the indebtedness of the ryots to any society or bank. The assessee has been issuing such certificates to its members by appending the same to be loan applications while forwarding the same to the bank. In this regard it has been collecting certain service charges from its members. For the assessment year 1983-84, the society filed its returns of income-tax. In the returns it claimed exemption of Rs. 93,360 collected towards service charges. However, the Income Tax Officer treated the same as income from other sources. In the appeal, the Commissioner allowed the claim of the assessee. Having been aggrieved by the same, the department filed the appeal before the Tribunal. The Tribunal by its order' dated 20-6-1989 dismissed the appeal. The Tribunal, inter alia, in its order found that the amount of Rs. 93,360 received by the assessee towards service charges would partake of the nature of business receipts and entitled to be deducted under section 80P of theAct.The Commissioner, Visakhapatnam, therefore, filed an application under section 256(1) before the Tribunal seeking a reference to this Court. Accordingly, the Tribunal while referring the matter framed the following question of law for consideration:

"Whether, on the facts and in the circumstances of the case, the Appellate Tribunal is correct in law in holding that the amount of Rs. 93,360 received from its members qualified for exemption under section 80P (2)(a)(z) of the Income Tax Act, 196 1, especially when the assessee acted only as an agent between its members and bank without the involvement directly or indirectly in the matter of repayment of loan ?"

3. We have heard the learned counsel appearing for the revenue and the learned counsel appearing for the assessee

3. We have heard the learned counsel appearing for the revenue and the learned counsel appearing for the assessee.Before proceeding to consider the relative contentions advanced on either side and the point involved, it is appropriate and expedient here at this stage to refer to section SOP, the relevant provision in the Act insofar as is relevant for the present purposes for brevity and better appreciation of the point involved in this case. The section reads thus :

"80P. Deduction in respect of income of co-operative societies.-()) where, in the case of an assessee being a co-operative society, the gross total income includes any income referred to in sub-section (2), there shall be deducted, in accordance with and subject to the provisions of the section, the sums specified in sub-section (2), in computing the total income of the assessee.

(2) The sums referred to in sub-section (1) shall be the following, namely
(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
(ii) a cottage industry, or
(iii) the marketing of the agricultural produce of its members, or
(iv) the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purpose of supplying them to its members, or
(v) the processing, without the aid of power, of the agricultural produce of its members, or
(vi) the collective disposal of the labour of its members, or
(vii) fishing or allied activities, that is to say, the catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipments in connection therewith for the purpose of supplying them to its members, the whole of the amount of profits and gains of business attributable to anyone or more of such activities:" (Emphasis supplied)

4. It is apparent from a plain reading of the above provision that if the assessee is a co-operative society, its income referred to in sub-section (2) shall be deducted in computing the total income of the assessee. The income referred to in sub-section (2) is the whole of the amount of profits and gains derived by, the society in engaging itself in carrying on the business attributable to anyone or more of such activities referred to in sub-clauses (i) to (vii) of sub-section (2)(a) of section SOP. Sub-clause (1) of sub-section (2)(a) is apposite here for consideration. It envisages two categories of businesses, namely, (1) engaging in carrying on the business of banking, and (2) engaging in the business of providing credit facilities to its members. We are not concerned with the former category of business. The latter category of business and the income derived therefrom is germane for consideration in this reference. The twin requirements clearly discernible from a perusal of the above provision are : (1) providing credit facility must be one of the activities of the assessee, and (2) the income attributable to such an activity must be towards profits or gains therefrom.

4. It is apparent from a plain reading of the above provision that if the assessee is a co-operative society, its income referred to in sub-section (2) shall be deducted in computing the total income of the assessee. The income referred to in sub-section (2) is the whole of the amount of profits and gains derived by, the society in engaging itself in carrying on the business attributable to anyone or more of such activities referred to in sub-clauses (i) to (vii) of sub-section (2)(a) of section SOP. Sub-clause (1) of sub-section (2)(a) is apposite here for consideration. It envisages two categories of businesses, namely, (1) engaging in carrying on the business of banking, and (2) engaging in the business of providing credit facilities to its members. We are not concerned with the former category of business. The latter category of business and the income derived therefrom is germane for consideration in this reference. The twin requirements clearly discernible from a perusal of the above provision are : (1) providing credit facility must be one of the activities of the assessee, and (2) the income attributable to such an activity must be towards profits or gains therefrom.Here, in this case, loans have been granted to the members of the assessee by the State bank of India, Anakapalli Branch. It may be reiterated here that one of the objects of the assessee is to arrange credit facilities to its members through the State bank of India, Anakapalli Branch. The expression "engaged in providing credit facilities to its members" is the subject-matter of interpretation in the first instance. The amount of Rs.. 93,360 collected towards service charges by the assessee could be reckoned as the amount of profits and gains of business attributable to the activity of providing credit facilities to its members by the assessee and is yet another moot question.

5. The learned counsel for the assessee submits that the phrase "providing credit facility to its members" does not mean that the society itself should lend, but it may see through another agency that the facility is provided. It is his further contention that the service charges being collected by the assessee-bank from its members constitute the income by providing such credit facility. Apropos the first requirement as set out supra, the facts disclose that the assessee has been forwarding the loan applications of its members to the State bank of India, Anakapalli Branch. While forwarding the same, it is true that the necessary certificate is being appended on the applications so as to satisfy the requirements of the bank and recommending the sanction of loans in favour of its members. As regards the second requirement, the assessee is collecting service charges from its members as it involved the deputation of a person for making personal inspection. Such an act on the part of the assessee-bank can be reckoned as an activity of the assessee or not and the amount collected towards service charges can be treated as an income of the assessee are the two issues to be adjudicated upon in this case. To buttress both the above contentions much reliance has been placed by the learned counsel upon the judgment of the Allahabad High Court in CIT *v. U.P. Co-operative Cane Union Federation Ltd*[1]. A Bench of the Allahabad High Court held thus :

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loans in favour of its members. As regards the second requirement, the assessee is collecting service charges from its members as it involved the deputation of a person for making personal inspection. Such an act on the part of the assessee-bank can be reckoned as an activity of the assessee or not and the amount collected towards service charges can be treated as an income of the assessee are the two issues to be adjudicated upon in this case. To buttress both the above contentions much reliance has been placed by the learned counsel upon the judgment of the Allahabad High Court in *CIT v. U.P. Co-operative Cane Union Federation Ltd*[2]. A Bench of the Allahabad High Court held thus :

"On these observations, the expression 'providing credit facilities' would comprehend the business of lending money on interest. We might add that it would as well comprehend the business of lending services on profit for guaranteeing payments. We say so because guaranteeing payments is as much a part of banking business for affording credit facility as advancing loans...." (p. 916) According to the facts in that case, the society was assessed for the income over the printing press and service charges for the supply of pumping sets by Southern Engineering, repelling its plea for exemption. The applications for purchasing the pump sets were processed by the society and it stood as guarantor for the payment. The society took the responsibility for the payment of the invoice price within seven days from the date of the invoice and it is also responsible for the payment. It has undertaken the liability for making available the loans to the farmers either from its own resources or from the financing institutions. Thus, the society has provided credit facilities to the cane-growers who purchased pumping sets. The final payment was guaranteed by the society. The Southern Engineering Works in consideration of the services rendered by the society agreed to pay service charges to the Federation at the rate of 5 per cent to be calculated on the price of the pump-sets. Under the circumstances, it was held that the expression 'providing credit facilities' would comprehend the business of lending services on profit for guaranteeing payments, inasmuch as guaranteeing payments is as much a part of banking business for affording credit facility as advancing loans. However, the Bench was of the view that the cane-growers who purchased the pump sets were not the members of the society and ultimately held that the income from service charges was not exempted from taxing. The Allahabad High Court placed reliance upon its earlier judgment rendered by another Bench in Addl. CITv. U.P. Co-operative Cane Union (1978) 114 ITR 70. The relevant observations of the Bench in its earlier judgment have been quoted with approval, thus:"... In our opinion, the income which is exempt from tax is income arising from a business of providing credit facilities and not merely of selling goods on credit. A person who sells goods on credit cannot be said to be carrying on the business of providing credit facilities. His business will be the business of purchase and sale of goods which he supplies. Banking business is a wide term and includes many activities like discounting bills, hundis, cheques, accepting deposits and advancing loans, etc. Thus, it includes the providing of credit facility. A person or a society may not be a banker, in that wide sense, yet he may be providing credit facilities which is a part of a banking business. The expression 'providing credit facility', thus, takes its colour from the activity of banking. In order that a banking or providing of credit facility may constitute a business, it is necessary that these activities must be the chief source of income. A person who advances loans or supplies goods on credit in connection with and in the course of some other business of manufacture or purchase or sale of goods, etc., cannot be said to be carrying on the business of banking or providing credit facilities. In order that a person may be engaged in the business of providing credit facilities, it must be shown that the providing of credit facility is his business in the sense that the interest earned by him is the main source of his income (Emphasis supplied) (p. 72) It is

obvious even from the excerpts extracted supra that the twin requirements to be satisfied Pare (1) providing credit facility must be one of the activities of the society, and (2) the income derived therefrom as a profit or gain shall be one of the main sources of income. Returning to the facts of the instant case, issuing the requisite certificate while forwarding the loan applications and recommending the sanction of the loans de hors guaranteeing the payment and earning profits or gains thereby, under the facts and circumstances of this case, cannot be said to be an activity of the society. Even if the expression "engaged in the business of providing credit facilities to its members" is stretched so as to construe that it comprehends the business of providing credit facilities through the State bank of India, Anakapalli Branch also, as is done by the Allahabad High Court referred to supra, that act in isolation de hors the other act of guaranteeing the payments and undertaking the responsibility of repayment thereby making it as a source of income cannot reasonably be construed as one of the activities of the assessee. The judgment of the Allahabad High Court, therefore, has no application to the facts of this case. Reliance has also been placed by the learned counsel upon the judgment of the Kerala High Court in CITv. Kottayam Co-operative bank Ltd. (1974) 96 ITR 181. That was a case where the assessee-co-operative society was doing banking business and as a part of its business activity it was also conducting chit funds from about the year 1959. The income derived from the conduct of the chit funds was not subjected to tax till the assessment year 1969-70. For the assessment year 1969-70, it was subjected to tax by the Income Tax Officer. In the eventual reference to the High Court, it was held that the chit fund was primarily intended to operate as a scheme for advancing loans from the common fund to the subscribers, their turn for getting such loans being determined either by auction or by drawing lots and, therefore, by conducting the chit funds the assessee was providing credit facilities to its members and the income earned by the assessee from the said business was entitled to deduction. Since the society has directly involved in a chit fund business, there can be no gainsaying that it is part of its activity. That decision, therefore, has no application to the facts of the instant case.The learned counsel appearing for the revenue relied upon, on the other hand, the judgment of this court in A.P. Co-operative Central Land Mortgage bank Ltd. v. CIT (1975) 100 ITR 472. According to the facts in that case, the assessee-society earned income by way of interest on securities. The Income Tax Officer deducted the tax at source for that income, while negativing the claim of the assessee for refund of the same on the ground that it was entitled to an exemption from tax under section 81(i)(a) or under section 81 (v) of the Act. In the eventual reference ultimately this court held, having due regard to the bye-laws of the society and its objects, that in order to earn exemption contemplated under section 81(i)(a), the society must prove that it has engaged itself in carrying on the business of banking or providing credit facilities to its members and that the profits and gains sought to be exempted are earned or made in the business carried on by it. Where the co-operative society has earned any profits or gains not pertaining to its business but by mere investment in the Government securities, or in any other manner, such categories of income are not exempt from income-tax under section 81(i)(a). This court has further held as follows:

". . . The business of the assessee must have a direct or proximate connection with or nexus to the earnings in order to attract the provisions of section 81(1). Under section 81(i)(a) unless and until the assessee establishes that the income sought to be exempted was earned in carrying on the business of banking or providing credit facilities to its members, its claim to exemption must be rejected." (p. 472)

6. It is obvious from the above judgment of this court that the income earned by the society must

have a direct or proximate nexus or connection with the business of the society. Turning to the instant case, there is no evidence to show that service charges being collected by the assessee constitute one of the sources of income and is attributable to the business of providing credit facilities. The assessee should engage itself in the business of providing credit facility to its members. If the society, makes any profit or gain out of business attributable to such an activity, then that income earned by the society by way of profit or gain qualifies for exemption under section SOP(2)(a)(i). But here is a case where the society is not deriving any commission by extending that facility to its members through the State bank of India. The society has not offered any guarantee to the bank. What all it is expected to do is to append a certificate in regard to the particulars of the land, crop grown and the indebtedness of the grower while forwarding the application to the bank. By no stretch of imagination it can be said that by appending such a certificate, which is a sine qua non, for granting of loan by the bank, the society is making a profit out of it. By doing so, the society is no doubt facilitating its members to obtain a loan from the bank. What the society is getting by appending the necessary certificates is the service charges as a quid pro quo but certainly not as a profit or gain arising out of the activity of providing credit facility. There is no proof that the income derived through service charges constitutes one of the sources of income of the assessee from the activity of providing credit facilities to its members.

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7. It is the cardinal principle of interpretation of statutes that while interpreting the taxing statutes they shall be construed strictly either because of legislative intention or on economic justification of inequitable burden or progressive approach of fiscal provisions intended to augment the State revenue. The Apex court in *Union of India v. Wood Papers Ltd*[3]. held as follows:

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revenue. The Apex court in *Union of India v. Wood Papers Ltd*[4]. held as follows:

"4. Entitlement of exemption depends on construction of the expression 'any factory commencing production; used in the Table extracted above. Literally exemption is freedom from liability, tax or duty. Fiscally it may assume varying shapes, specially, in a growing economy. For instance tax holiday to new units, concessional rate of tax to goods or persons for limited period or with the specific objective, etc. That is why its construction, unlike charging provision, has to be tested on different touchstones. In fact an exemption provision is like an exception and on normal principle of construction or interpretation of statutes it is construed strictly either because of legislative intention or on economic justification of inequitable burden or progressive approach of fiscal provisions intended to augment State revenue. But once exception or exemption becomes applicable no rule or principle requires it to be construed strictly. Truly speaking liberal and strict construction of an exemption provision are to be invoked at different stages of interpreting it. When the question is whether a subject falls in the notification or in the exemption clause, then it being in the nature of exception is to be construed strictly and against the subject but once ambiguity or doubt about applicability is lifted and the subject falls in the notification then full play should be given to it and it calls f or a wider and liberal construction. Therefore, the first exercise that has to be undertaken is if the production of packing and wrapping material in the factory as it existed prior to 1964 is covered in the notification." (p. 260) The above excerpt has been extracted with approval by the Apex court in its latest judgment in *Grasim Industries Ltd. v. State of M.P*[5].

8. The burden is on the assessee, which is seeking to claim benefit of exemption to show that it is covered by the said exemption. Therefore, it must invariably show that it forwarded the loan applications pursuant to one of its activities of providing credit facilities to its members and that the service charges collected by the society have proximate nexus to the business of providing credit facility. Nay, it should further show that the service charges it is collecting are towards profit or gain which constitute as one of the sources of income of the society attributable to one or other activities enumerated in sub-clauses (i) to (v) of sub-section (2)(a) of section 80P in order to qualify for an exemption. In, the absence of any such proof per se, it cannot be said that forwarding applications to State bank of India, Anakapalli Branch, by issuing the requisite certificate while recommending the loans, is an activity of the assessee and it cannot also be said that the amount of Rs. 93,360 collected towards service charges has got a proximate nexus or close connection with any of the activities of the society. Nor it can be said that the society is making any gain or profit out of it. Nor it can be said that the said income is one of the sources of income of the assessee.

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that the amount of Rs. 93,360 collected towards service charges has got a proximate nexus or close connection with any of the activities of the society. Nor it can be said that the society is making any gain or profit out of it. Nor it can be said that the said income is one of the sources of income of the assessee.

9. For the foregoing reasons, we are of the considered view that the amount of Rs. 93,360 received by the assessee from its members as service charges does not qualify for an exemption under section 80P(2)(a)(i). Accordingly, the reference is answered in favour of the revenue and against the assessee.

9. For the foregoing reasons, we are of the considered view that the amount of Rs. 93,360 received by the assessee from its members as service charges does not qualify for an exemption under section 80P(2)(a)(i). Accordingly, the reference is answered in favour of the revenue and against the assessee.

Cases Referred.

1(1980) 122 ITR 913
2(1980) 122 ITR 913
331990 (4) SCC 256
41990 (4) SCC 256
51999 (8) SCC 547