**KERALA HIGH COURT**

Malabar Co-Operative Central

Vs

Commissioner of Income-Tax

(P Govindan Nair, C.J. K Sadasivan, J.)

10.10.1973

**JUDGMENT**

**Govindan Nair, C.J**.

1. The question is

> "Whether, on the facts and in the circumstances of the case, the interest on securities received by the assessee amounting to Rs. 49,086 is exempt from tax under Section 80P(2)(a)(i) of the Income-tax Act, 1961 ?"

2. The question has been referred to us by the Income-tax Appellate Tribunal, Cochin Bench, as arising from the order of the Tribunal in the matter of the assessee, the Malabar Co-operative Central Bank Ltd., Calicut, in relation to the assessment year 1968-69, the corresponding previous year having ended on June 30, 1967. During that period the assessee earned Rs. 49,086 by way of interest on securities. This amount, it was contended by the assessee, should be exempted under Section 80P(2)(a)(i) of the Income-tax Act, 1961, for short, the Act. This contention had been rejected by the Tribunal. The assessee is a co-operative society carrying on banking business. The submission on behalf of counsel for the assessee is that the Banking Regulation Act, 1949, has been made applicable to the assessee and that the banking business as defined in Section 5A of the Banking Regulation Act, 1949, read with the provisions in Section 6(1)(a) and (1) of the same Act detailing the forms of business, taken along with the compulsion imposed on the assessee by Section 24 of that Act, clearly indicate that the holding of securities, the realisation of those securities, the earning of interest from those securities, all spell carrying on of the business of the banking institution and that, therefore, the interest that is accrued on the securities should be treated as business income. This submission naturally implies that the securities held by the assessee is stock-in-trade. Counsel for the revenue, Sri P. A. Francis, pointed out that the assessee is not entitled to proceed under that assumption as the Tribunal has definitely found that the securities held by the assessee are not stock-in-trade and that question is a pure question of fact, and that question not having been referred to this court we are precluded from going into the matter. This is what the Tribunal said in this regard:

> "It has been of course stressed that the assessee was required under Section 24 of the Banking Regulation Act, to invest in securities or keep cash or gold to the extent of 20%

> of its time and demand liabilities. But such a provision would appear to curb the propensity (sic. propensity) of the smaller banks to over-trade at the expense of liquidity and to ensure the maintenance of a reasonably large proportion of the cover in the form of cash or gold or approved securities. Maintenance of such assets (cash, gold or securities) to the statutory extent is no doubt part of banking operations but no further presumtion arises (to the effect) that such assets represent the stock-in-trade of the bank. Such assets may acquire the character of trading assets in the course of the banking business and be realised as such or may remain simply as capital assets. Hence, nothing much turns on the argument regarding the statutory compulsion for investment in the securities in question, as regards the narrow issue in dispute before us. The assessee not having discharged the burden of showing that the securities did represent its stock-in-trade, we hold that the Appellate Assistant Commissioner was justified in rejecting the assessee's claim under Section 80P(2)(a)(i)."

3. It is no doubt true that a finding entered by the Tribunal on a question of fact is final unless in extraordinary circumstances as when the finding was entered without material or was otherwise arbitrary or perverse and the very finding was questioned before us in the reference to this court. It is equally true that if the question referred comprehends other questions so that the other questions formed aspects of the question referred, this court is entitled to go into the matter of the other aspects in answering the question referred. On the facts and in the circumstances of the case, we find it difficult to say that what has been said by the Tribunal in the paragraph that we have extracted above from its order is a finding on a question of fact. It appears to us that the Tribunal has proceeded under a misconception of the nature of the business of a banking institution. It has also cast the burden on the assessee and has blamed the assessee for not discharging that burden and the rejection of the claim for excluding the interest earned from securities under Section 80P(2)(a)(i) of the Act is exclusively based on the inability of the assesses to discharge the burden that the securities were really stock-in-trade. A reading of the order of the Tribunal as a whole indicates that this burden will get discharged only in cases where the banking institution had been able to establish that as a matter of practice it had been selling and buying securities or dealing with it otherwise often, if not frequently, as if buying and selling securities formed its basic or essential business. We think this is a completely wrong approach to the question. A banking institution, as we understand it, as a part of its business activity will have to have ready resources to meet its liabilities the extent of which can never be foreseen. It must, therefore, have liquid resources which of course will normally be cash, and, secondly, easily realisable securities. This is in the interest of the banking institution and it is in the interest of the public that deal with the bank. Taking the latter aspect into consideration the legislature has stepped in and has made it obligatory that the banking institutions must maintain a certain percentage, one fifth of its assets, in the form of securities at any given day. This is one of the legislative restrictions, on the otherwise unlimited freedom of a banking institution to conduct its business in any manner it liked. Any prudent banking institution will so invest in securities even without legislative compulsion. If it did, holding of securities cannot be presumed to be not a part of its business, nor can it be said that the securities held are not part of its stock-in-trade. The fact that law now insists that the business must be run in a prudent manner by holding a specified part of its readily realisable resources in securities does not detract from the provision that in so holding securities the bank is carrying on its business and securities so held are stock-in-trade. Further, we do not think that the securities so held by a banking institution must be dealt with daily or often in order that those securities might become stock-in-trade. Supposing the

institution kept a few lakhs of rupees either in its safe to meet emergent calls on the banks by the depositors or it maintained in the form of short-term deposits cash in other banking institutions, can it be said that it was not doing its business, that the cash was actually not in circulation, and, therefore, it did not form circulating capital and was, therefore, not part of its stock-in-trade ? Certainly not; and we have the authority of the Supreme Court itself that cash kept, by a banking institution in other banking institutions in the form of short-term deposits was maintained by the banking institution as a part of its business and that the income that accrued to the bank in the form of interest from deposits so held is income from business of the banking institution. We may read the relevant passage from the decision of the Supreme Court in *Bihar State Co-operative Bank Ltd. v. Commissioner of Income-tax*[1],

> ".....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."

4. The so-called finding of the Tribunal is not a finding after considering any evidence in the matter but, as we indicated, arose out of an assumption that even in the case of a banking institution the securities held by a banking institution which it is required by law to maintain, in the absence of proof of dealing with those securities, was capital and not stock-in-trade. This is a clearly erroneous view of law and, therefore, we think that it is not the decision of the Supreme Court relied on by counsel for the revenue in *Commissioner of Income-tax v. Associated Industrial Development Co. (P.) Ltd.*[2], that has to be applied but it is the principle of the decision of the Supreme Court in *Commissioner of Income-tax v. Indian Molasses Co. P. Ltd.*[3], should be applied. The principle in Commissioner of Income-tax v. Indian Molasses Co. P. Ltd. is the same as that laid down by the Supreme Court in*Commissioner of Income-tax v. Scindia Steam Navigation Co. Ltd.*[4], The question whether the securities held by the assessee's co-operative society-bank is stock-in-trade or not is an aspect of the question that has been referred to us and we do not think we are precluded from considering this aspect. What we have said is sufficient to come to the conclusion that this aspect has to be decided in favour of the assessee. If money held in short-term deposit for the same purpose as the securities held by the assessee is part of its normal banking business and the income earned from that money is income from business as has been held by the Supreme Court in Bihar State Co-operative Bank Ltd. v. Commissioner of Income-tax, [1960] 39 ITR 114 (SC)., we can have no hesitation whatever in saying that the income earned by the assessee from the securities held by the assessee in the form of interest is also income from the business of the assessee-bank.

5. Certain observations in certain cases to the effect that income from interest comes under a

different head under the Income-tax Act and, therefore, such income cannot be treated to be business income will have to be adverted to before closing this case. Only if interest income is business income, Section 80P(2)(a)(i) of the Act would apply. We have no doubt held that this is business income but it is necessary to clarify the position. We shall read a passage from the judgment of the Supreme Court in *Commissioner of Income-tax v. Chugandas and Co.,*[5]

"The heads described in Section 6 and further elaborated for the purpose of computation of income in Sections 7 to 10 and 12, 12A, 12AA and 12B are intended merely to indicate the classes of income : the heads do not exhaustively delimit sources from which income arises. This is made clear in the judgment of this court in United Commercial Bank Ltd.'s case, [1957] 32 ITR 688 (SC)., that business income is broken up under different heads only for the purpose of computation of the total income : by that break-up the income does not cease to be the income of the business, the different heads of income being only the classification prescribed by the Indian Income-tax Act for computation of income."

6. In the decision of the Supreme Court in *Commissioner of Income-tax v. Cocanada Radhaswami Bank Ltd.*[6], it is stated :

"The Act provides for the setting off of loss against profits in four ways. To illustrate, take the head 'profits and gains of business, profession or vocation'. An assessee may have two businesses. In ascertaining the income in each of the two businesses, he is entitled to deduct the losses incurred in respect of each of the said businesses. So calculated, if he has loss in one business and profit in the other both falling under the same head, he can set off the loss in one against the profit in the other in arriving at the income under that head. Even so, he may still sustain loss under the same head. He can then set off the loss under the head 'Business' against profits under another head, say 'Income from investments', even if investments are not part of the trading assets of the business. Notwithstanding this process he may still incur loss in his business. Section 24(2) says that in that event he can carry forward the loss to the subsequent year or years and set off the said loss against the profit in the business. Be it noted that Clause (2) of Section 24, in contradistinction to Clause (1) thereof, is concerned only with the business and not with its heads under Section 6 of the Act. Section 24, therefore, is enacted to give further relief to an assessee carrying on a business and incurring loss in the business though the income therefrom falls under different heads under Section 6 of the Act."

7. These decisions of the Supreme Court have been followed by the Allahabad High Court in *U. P. Co-operative Bank Ltd. v. Commissioner of Income-tax*[7],

8. Though the interest earned from securities will now fall under Section 18 of the Act, if that interest represents income from business the fact that for the purpose of computation of the income the income may have to be taken under a specific head of interest from securities is of no moment in deciding whether the interest, represented business income. We have already held that the sum of Rs. 49,086 is business income. If that be so, Section 80P(2)(a)(i) of the Act in terms will apply. That Section is in these terms:

"80P. (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....."

9. The sum of Rs. 49,086 should have been exempted as provided. We, therefore, answer the question referred to us in the affirmative, that is, in favour of the assessee and against the department. We direct the parties to bear their respective costs as the question involved is a fairly complicated one on which there has been no clear ruling of this court.

10. A copy of this judgment under the seal of the High Court and the signature of the Registrar will be forwarded to the Income-tax Appellate Tribunal, Cochin Bench.

Cases Referred.

1[1960] 39 ITR 114, 122 (SC)
2[1971] 82 ITR 586 (SC)
3[1970] 78 ITR 474 (SC)
4[1961] 42 ITR 589 (SC)
5[1965] 55 ITR 17, 24 (SC)
6[1965] 57 ITR 306, 310 (SC)
7[1966] 61 ITR 563 (All)