

HIGH COURT OF ALLAHABAD  
**Commissioner of Income-tax**  
v.  
**Gulshan Mercantile Urban Co-Operative Bank Ltd.**  
IT Appeal No. 429 of 2009  
November 7, 2012  
**ORDER**

1. We have heard Shri Dhananjay Awasthi for the Income Tax Department. Shri Ashok Trivedi appears for the respondent assessee.

2. In this income tax appeal under Section 260-A of the Income Tax Act, 1961 (in short the Act) the Commissioner of Income Tax, Muzaffar Nagar has raised the following questions of law to be considered by the Court:-

“(1) Whether on the facts and in the circumstances of the case, the Tribunal is justified in law in holding that interest earned by the assessee which is a Co-operative Bank on the deposits of its non-SLR funds is income from Banking Business and consequently exempt u/s 80-P (2) (a) (i) of the I.T. Act, 1961?

(2) Whether on the facts and in the circumstances of the case, the Tribunal is justified in law in holding that interest earned on deposits of its non-SLR funds are also covered within the meaning of Section 80-P(2)(a) (i) of the Act?

(3) Whether on the facts and in the circumstances of the case, the Tribunal is justified in law in holding that interest on Non-SLR investment is exempt u/s 80-P (2) (a) (i) ignoring that the definition of financing Bank or Central Bank in U.P. Co-operative Society Act does not refer to Section 5 or 6 of Banking Regulation Act and restrict banking business to only members of the co-operative societies of the assessee’s bank?”

3. Shri Dhananjaya Awasthi states that so far as Statutory Liquidity Ratio (SLR) Funds are concerned, the Supreme Court has held in CIT v. Karnataka State Cooperative Apex Bank [2001] 251 ITR 194; Mehsana District Central Co-operative Bank Ltd. v. ITO [2001] 251 ITR 522; and CIT v. Nawanshar Central Co-operative Bank Ltd. [2007] 289 ITR 6 that the cooperative bank carrying on business of banking is statutorily required to place a part of its funds in approved securities. The income as interest from such deposits of SLR Funds in the approved security, is an income, which is attributable to the business of bank and is deductible under Section 80P(2)(a)(i) of the Act. He submits that so far as non-Statutory

Liquidity Ratio (SLR) Funds are concerned, the interest arising out of deposits of such excess funds kept in short term securities would not be subject to deduction under Section 80P(2)(a)(i) of the Act. He submits that the question whether interest on the deposit of non-SLR funds are concerned, in *Mehsana District Central Co-operative Bank Ltd. (supra)*, the Apex Court remanded the matter to the Commissioner (Appeals) for deciding the matter afresh. The short judgment of the Supreme Court is quoted as below:-

“Civil Appeals Nos. 7448 and 7449 of 2000 :

The only question in these appeals reads thus :

“Whether, in the facts and circumstances of the case, the Income-tax Appellate Tribunal was right in law in holding that the assessee is not eligible for deduction under Section 80P in respect of interest income on its total reserve, and in holding so, ignoring its own decision as also the judgments of the Rajasthan High Court and the Supreme Court?”

Insofar as the interest income upon statutory reserves is concerned, the question must be answered in favour of the assessee, in the light of the judgment delivered by us in *CIT v. Karntilaka Stain Co-operative Apex Bank [2001] 251 ITR 194 (Civil Appeals Nos. 46464648 of 2000)* As far as the interest income on non-statutory reserves is concerned, the matter is remanded to the Commissioner (Appeals) for being decided afresh in the light of the decision that we have just rendered in Civil Appeals Nos. 292-298 of 2001.

Accordingly, the civil appeals are allowed and the judgment under appeal is set aside.

No order as to costs.”

**4.** Shri Dhananjaya Awasthi submits that this Court considered the question regarding the interest earned by the cooperative bank on deposits of its non-SLR funds, qualifying for deduction under Section 80P(2)(a)(i) of the Act [*Income Tax Appeal No.83 of 2007, CIT v. District Cooperative Bank Ltd. decided on 6.1.2010*]. All these judgments relate to SLR funds. So far as non-SLR funds are concerned, the question may be decided by this Court. He submits that the Court may refer the judgment in *District Cooperative Bank Ltd. (supra)* to Larger Bench.

**5.** Shri Ashok Trivedi appearing for the respondent-assessee bank submits that the question relating to non-SLR funds is also covered by the same ratio and reasoning as in the case of *Karnataka State*

Cooperative Apex Bank (Supra); Mehsana District Central Cooperative Bank Ltd. (Supra) and Nawanshahar Central Co-operative Bank Ltd. (Supra). He submits that the Supreme Court in Bihar State Co-operative Bank Ltd. v. CIT [1960] 39 ITR 114 considered the question of the applicability of the notification exempting the income of cooperative bank from interest received from deposits and held that the placement of funds by cooperative bank in deposits with other banks, on long term deposits would amount to income arising from banking business. Shri Bansal submits that this question has also been decided by the Gujarat High Court and Bombay High Court. In CIT v. Baroda Peoples Co-operative Bank Ltd. [2006] 280 ITR 282, the Gujarat High Court held that the interest arising out of deposits of non-SLR funds by cooperative bank would qualify for deductions under Section 80P(2)(a)(i) of the Act. The Andhra Pradesh High Court in CIT v. Andhra Pradesh State Cooperative Bank Ltd. [2011] 200 Taxman 220 well as the Bombay High Court in CIT v. Goa Urban Co-operative Bank Ltd. [Tax Appeal Nos.6 and 8 of 2005, and in Tax Appeal No.54 of 2008 decided on 15.7.2009] have also held that the interest from the excess investment made in SLR securities will be subject to deduction under Section 80P(2)(a)(i).

**6.** We have considered the respective submissions and find that though the question involved in The District Cooperative Bank Ltd.,(supra) was the qualification of deduction of the interest on deposits of non-SLR funds by cooperative bank under Section 80P(2)(a)(i) of the Act, the Court followed the judgments, which were rendered in the matter of interest earned by the cooperative banks on deposits of SLR funds.

**7.** In our view the ratio of the judgments, which are applicable to SLR funds would also be equally applied to non-SLR funds as it cannot be said on the basis of the judgment of the Supreme Court in Bihar State Co-operative Bank Ltd. (Supra) and the judgments rendered by the Gujarat High Court, Andhra Pradesh High Court and Bombay High Court in the cases cited as above, that the interest earned out of deposits of non-SLR funds, cannot be treated as profits and gains of business attributable to the activity of carrying on business of banking, or providing credit facilities to its members under Section 80P(2)(a)(i).

**8.** The Supreme Court in Bihar State Co-operative Bank Ltd. (Supra) explained in para 12 and 13 that the interest earned out of deposits of surplus fund has to be treated as interest earned in the banking business. Paras 11, 12 and 13 of the judgment are quoted as below:-

“11. In the Surat Peoples’ Co-operative Bank Ltd. v. The Commissioner of Income-tax, Ahmedabad (2) 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.

12. 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 *The Punjab Cooperative Bank Ltd. v. The Commissioner of Income-tax, Lahore* [1940] 8 ITR 635 where the profits arose from the sale of Government securities pointed out at p. 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 realizable 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 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.

13. 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 byelaws 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 s. 19 of the Bihar Act (Cl. 4 111(i) of the Bye-Laws). Whether funds invested as provided in s. 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 there from did not form part of its business profits. Under the bye-laws 68 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 heads under s. 6 of the Income Tax Act and the provisions of that Act applicable to these various heads 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 [1933] 1 ITR 197.”

9. The Bombay High Court in Goa Urban Co-operative Bank Ltd. (Supra) has held in paras 2 and 3 as follows:-

“2. The facts are hardly in controversy. The investment by the assessee Bank is in excess of statutory liquidity ratio i.e. 25% of demand and liabilities in terms of Section 24 of the Banking Regulation Act. However, the excess investment made in SLR securities were subjected to taxation by the Assessing Officer vide his Order dated 24th February, 1999 which was upheld in appeal by the Commissioner of Income Tax(Appeals). It was felt by the authorities that the income from any investments coming out of SLR would be entitled to deduction under Section 80P(2)(a)(i) in terms of the Judgment of the Supreme Court in M.P. Co-operative Bank Ltd. v. Additional CIT MANU/SC/1085/1996 : 218 ITR 438 only if it was income from the banking business. These amount had been invested in approved securities by the Assessee Bank i.e. the Central Bank and other trust securities. Noticing that the object of Section 80P(2)(a)(i) was to encourage co-operative movement in the country and any income of the society from the investment which does not form part of the circulating capital or working capital or stock-in trade of the banking business cannot be said to be the profits and gains attributable to the business of banking and entitled to deduction under Section 80P(2)(a)(i), on these reasonings, the Commissioner declined to interfere in the appeal. The Income Tax Appellate Tribunal while upholding both these orders whilst referring to the Judgment of the Gujarat High Court in the case of Commissioner of Income Tax v.

Baroda Peoples Co-operative Bank Ltd. MANU/GJ/0493/2005 : (2006) 280 ITR 282 followed the principle while referring to the Special Bench Judgment of the Ahmedabad High Court in the case of Surat District Co-operative Bank Ltd. (2003) 262 ITR (AT) 1 and held as under:

“In this case, it was held by the Special Bench of the Tribunal that the interest income on investment in government securities, fixed deposits, KVPs and IVPs, investments with the Unit Trust of India, etc., out of surplus/idle money available from working capital including voluntary reserves, excess collection of interest-tax and locker rent are all income attributable to business of banking and are eligible for grant of deduction Under Section 80P(2)(a)(i) of the Act. Respectfully following the decision of the Special Bench of the Tribunal, we allow the appeal of the assessee.

In the result, the appeal filed by the assessee is allowed.”

3. The learned Counsel appearing for the Department has relied upon the Judgment of the Division Bench of the Bombay High Court in the case of C.I.T. v. Ratnagiri District Central Co-operative Bank Ltd. (2002) Vol.254 Income Tax Reports page 697 to contend that this deduction was not permissible. We are not inclined to accept this submission primarily in view of what is held in the case of C.I.T. v. Ratnagiri District Central Cooperative Bank Ltd. (supra) as the issues are no way different. In fact in that case while referring to the Judgment of the Supreme Court in the case of Bihar State Co-operative Bank Ltd. v. CIT (1960) 39 ITR 114 where the Apex Court clearly held that short-term deposits by the Bank was income from normal banking business and was, therefore, exempt from the liability to pay Income Tax. It was further specifically held in that case that since the society in that case was engaged in banking activity, its normal business was to deal in money and credit and, therefore, the money laid out in the form of short-term deposit did not cease to be a circulating capital and interest earned thereon, could not be other than income generated from the business of banking, and, was therefore exempt from tax. In the present case, the investments have been made by the Bank in government securities, fixed deposits, etc. and the income is utilized for business. There is nothing on record to show that this case of the assessee is not acceptable in view of the law clearly stated by the Bench of this Court, for which we have no reasons to disagree. We dismiss the appeal while answering the questions in favour of the assessee. By this order, we dispose of the appeal with reference to the facts of the case.”

**10.** The question as to whether the business is derived from or attributable to SLR or non-SLR funds would not make any difference for the purposes of qualifying the interest earned by the cooperative bank under Section 80P(2)(a)(i) as the deposits of surplus idle money available from working capital,

including reserves, excess collection of interest tax and other incomes are all attributable to the business of banking. The interest from such deposits cannot be said to be beyond the legitimate business activities of the bank.

**11.**For the aforesaid reasons, we do not find that the Income Tax Appellate Tribunal committed any error in arriving at findings that the interest are not deposits of non-SLR funds and the cooperative bank will qualify for exemption under Section 80P(2)(a)(i) of the Act.

**12.** The question Nos.1, 2 and 3 framed as above, are consequently decided against the revenue and in favour of the respondent assessee. The department will proceed accordingly.