

COMMISSIONER OF INCOME TAX, KARNATAKA-III

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v.

KARNATAKA STATE COOPERATIVE APEX BANK

AUGUST 22, 2001

[S.P. BHARUCHA, Y.K. SABHARWAL AND ASHOK BHAN, JJ.]

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Income Tax Act, 1961: Section 80-P(2)(a)(i)

Assessee—Co-operative Bank—Imperative requirement to place part of funds with State Bank or Reserve Bank—Income derived from funds so placed—Held, such income is income derived from Assessee's business—Assessee not required to pay tax thereon—Provision contained in Section 80-P(2)(a)(i) does not make it applicable only to income derived from working or circulating capital.

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These appeals have been preferred by Revenue. The question in these appeals is whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the interest income of the respondent-Cooperative Bank arising from the investment made out of reserve fund is exempt under Section 80-P(2)(a)(i) of the Income Tax Act?

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Dismissing the appeals, the Court

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HELD : The assessee-Cooperative Bank is required to place a part of its funds with the State Bank or the Reserve Bank of India to enable it to carry on its banking business. This being so, any income derived from funds so placed arises from the business carried on by it and the assessee has not, by reason of Section 80-P(2) (a) (i), to pay income tax thereon. The placement of such funds being imperative for the purposes of carrying on the banking business, the income derived therefrom would be income from the assessee's business. There is nothing in the phraseology of Section 80-P(2) (a) (i) which makes it applicable only to income derived from working or circulating capital. [38-C-E]

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M.P. Cooperative Bank Ltd., Jabalpur v. Additional Commissioner of Income Tax Madhya Pradesh, Bhopal, [1996] 2 SCC 541, overruled.

Commissioner of Income Tax, Bangalore v. Bangalore District Cooperative Central Bank Ltd., [1998] 6 SCC 129, explained.

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A CIVIL APPELLATE JURISDICTION : Civil Appeal Nos. 4646-4648 of 2000.

From the Judgment and Order dated 12.1.2000 of the Karnataka High Court in I.T.R.C. Nos. 876-878 of 1998.

B Harish N. Salve, Solicitor General, Sanjiv Sen, B.V. Balram Das and Ms. Sushma Suri for the Appellant.

Ms. Asha Gopalan Nair for the Respondent.

The Judgment of the Court was delivered by

C **BHARUCHA. J.** These appeals have been referred to a Bench of three learned Judges, in view of the apparent conflict between the two judgments (of Benches of two learned Judges of this Court) in *M.P. Cooperative Bank Limited, Jabalpur v. Additional Commissioner of Income Tax, Madhya Pradesh, Bhopal*, [1996] 2 SCC 541 and *Commissioner of Income Tax, Bangalore v. Bangalore District Cooperative Central Bank Limited*, [1998] 6 SCC 129.

The question in appeal relates to, what was Section 80(i) and is now Section 80-P of the Income Tax Act, 1961, which reads thus :

E "80-P. (i) Where, in the case of an assessee being a cooperative 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 this section, the sums specified in sub-section (2), in computing the total income of the assessee.

F (2) The sums referred to in sub-section (1) shall be the following, namely :

(a) in the case of a cooperative society engaged in—

(i) carrying on the business of banking or providing credit facilities to its members, or

G (ii)-(vii) the whole of the amount of profits and gains of business attributable to any one or more of such activities :

The question in appeal reads :

H "Whether, on the facts and in the circumstances of the case, the Appellate Tribunal was right in law in holding that the interest income

arising from the investment made out of reserve fund is exempt under A
Sec.80-P (2) (a) (i) of the Income Tax Act ?"

In the case of *M.P. Cooperative Bank Limited*, this court noted instructions of the Madhya Pradesh Government which required the investment of the reserve funds of apex banks and observed that, by reason thereof no part of the Reserve Fund could be utilised as working capital nor could any part of the Reserve Fund deposits be withdrawn except with the permission of the Registrar to meet losses or at the time of winding up and not otherwise. In the circumstances, the Revenue contended that the securities relating to the Reserve Fund could never be considered to be the circulating or working capital of the bank or its stock-in-trade to qualify for exemption under Section 81 of the Income Tax Act. The court noted that a cooperative bank was legally obliged to place certain Government securities with the State Bank or the Reserve Bank of India and these securities could not be withdrawn by the bank at its will and could only be withdrawn in certain situations, as referred to hereinabove. It was, therefore, difficult, the court said, to comprehend how such Government securities relating to the reserve fund could be considered the bank's stock-in-trade or circulating capital. It was understood in banking parlance that circulating capital was that which was put into circulation or turned over to earn profit. Government securities coming out of the Reserve Fund, which could not be easily encashed and which could be utilised only when the contingencies mentioned arose, could not be considered circulating capital or stock-in-trade. The court, therefore, came to the conclusion, of first principles, that the interest on Government securities placed with the State Bank or the Reserve Bank of India would not qualify for exemption under Section 81 (now, Section 80-P) of the Income Tax Act. Such investment could not be regarded as an essential part of banking activity inasmuch as the same did not form part of stock-in-trade or working or circulating capital. B
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This judgment was cited before the Bench of two learned Judges which decided the case of the *Bangalore District Cooperative Central Bank Limited*. It was considered as having been rendered on its own facts and not applicable to the case of *Bangalore District Cooperative Central Bank Limited* in view of the finding of the Tribunal that the income in question was attributable to the business of that assessee. The court referred to the Banking Regulation Act, the Karnataka Cooperative Societies Act and the Karnataka Cooperative Societies Rules, which showed that the investments that had been made by the assessee were in compliance with the statutory provisions and in order to carry on the business of banking. They were necessary and, consequently, G
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A they were part of the business activities of the assessee falling within the scope of Section 80-P(2)(a)(i).

We do not agree with the finding of the Bench which decided the *Bangalore District Cooperative Central Bank Limited* case that the decision in the case of *M.P. Cooperative Bank Limited* was rendered on its own facts.

B The latter decision was clearly a reasoned decision.

The question is whether we agree with the reasoning in *M.P. Cooperative Bank Limited*. There is no doubt, and it is not disputed, that the assessee-Cooperative bank is required to place a part of its funds with the State Bank or the Reserve Bank of India to enable it to carry on its banking business.

C This being so, any income derived from funds so placed arises from the business carried on by it and the assessee has not, by reason of Section 80-P(2)(a)(i), to pay income tax thereon. The placement of such funds being imperative for the purposes of carrying on the banking business, the income derived therefrom would be income from the assessee's business. We are unable to take view that found favour with the Bench that decided the case of *M.P. Cooperative Bank Limited* that only income derived from circulating or working capital would fall within Section 80-P(2)(a)(i). There is nothing in the phraseology of that provision which makes it applicable only to income derived from working or circulating capital.

E In the premises, we take the view that the decision of this court in the case *M.P. Cooperative Bank Limited* does not set down the correct law and that the law is as we have put it above. The question, accordingly, is answered in the affirmative and in favour of the assessee.

F The civil appeals are dismissed.

No order as to costs.

T.N.A.

Appeals dismissed.