July 14, 2018

Impact of Recent Supreme Court Judgments on :
(Other few important judgments)

CO-OPERATIVE

TAXATION &

14A DISALLOWANCES

Pramod Shingte

Taxation for Co-operative Society

Definition of "Member"

Coverage of Sec 80P(4)

CITIZEN CO-OPERATIVE SOCIETY LIMITED
vs.
ASSISTANT COMMISSIONER OF INCOME TAX

(2017) 397 ITR 0001 (SC)

Issue :- Deductions u/s 80P—Deduction in respect of income of co-operative societies—Rejection of claim

Appellant :- Assesse

AO's

Contention:- held that deduction in respect of income of co-operative societies u/s 80P was not admissible to appellant as benefit of deduction, as contemplated under said provision was, inter alia, admissible to those co-operative societies which carry on business of banking or providing credit facilities to its members

Proceedings:-CIT(A) rejected claim for deduction thereby upholding order of AO—Appeal was also dismissed by Tribunal and High Court

CITIZEN CO-OPERATIVE SOCIETY LIMITED
vs.
ASSISTANT COMMISSIONER OF INCOME TAX

(2017) 397 ITR 0001 (SC)

Held :-

Appellant was engaged in activity of granting loans to general public as well—All this was done without any approval from Registrar of the Societies—With indulgence in such kind of activity by appellant, it was remarked by AO that activity of appellant was in violation of Co-operative Societies Act—Moreover, it was co-operative credit society which was not entitled to deduction u/s 80P(2)(a)(i)—Appellant could not be treated as co-operative society meant only for its members and providing credit facilities to its members and such society could not claim benefit of section 80P—Assessee's appeal dismissed.

Held – contd……

However, it is significant to point out that the main reason for disentitling the appellant from getting the deduction provided under Section 80P of the Act is not sub-section (4) thereof. What has been noticed by the Assessing Officer, after discussing in detail the activities of the appellant, is that the activities of the appellant are in violations of the provisions of the MACSA under which it is formed. It is pointed out by the Assessing Officer that the assessee is catering to two distinct categories of people. The first category is that of resident members or ordinary members. There may not be any difficulty as far as this category is concerned. However, the assessee had carved out another category of 'nominal members'. These are those members who are making deposits with the assessee for the purpose of obtaining loans, etc. and, in fact, they are not members in real sense. Most of the business of the appellant was with this second category of persons who have been giving deposits which are kept in Fixed Deposits with a motive to earn maximum returns.

Held – contd…..

A portion of these deposits is utilised to advance gold loans, etc. to the members of the first category. It is found, as a matter of fact, that the depositors and borrowers are quiet distinct. In reality, such activity of the appellant is that of finance business and cannot be termed as co-operative society. It is also found that the appellant is engaged in the activity of granting loans to general public as well. All this is done without any approval from the Registrar of the Societies. With indulgence in such kind of activity by the appellant, it is remarked by the Assessing Officer that the activity of the appellant is in violation of the Co-operative Societies Act. Moreover, it is a co-operative credit society which is not entitled to deduction under Section 80P(2)(a)(i) of the Act.

Definition of Co-operative Societies and Member
(As Per The Income Tax Act, 1961)

Definition of Co-operative Societies (Sec 19) of IT Act:

(19) "co-operative society" means a co-operative society registered under the Co-operative Societies Act, 1912 (**2** of 1912), or under any other law for the time being in force in any State for the registration of co-operative societies;

Definition of Member of Co-operative Societies:

Not defined in The Income Tax Act, 1961

Definition of Member

Andhra Pradesh Mutually Aided Cooperative Societies Act 1995 [Act No 30 of 1995]

2. Definitions

(p) "Member" means a member of a cooperative society;

The Maharashtra Co-operative Societies Act, 1960 [Maharashtra Act XXIV of 1961]

2. Definitions –

(19) (a) "member" means a person joining in an application for the registration of a Co-operative society which is subsequently registered, or a person duly admitted to membership of a society after registration and includes a nominal, associate or sympathizer member;

(b) "Associate member" means a member who holds jointly a share of a society with others, but whose name does not stand first in the share certificate;

(c) "Nominal member" means a person admitted to membership as such after registration in accordance with the bye-laws;

(d) "Sympathizer member" means a person who sympathizes with the aims and objects of the society and who is admitted by the society as such member;

More About Nominal And Sympathizer Member

(As Per The Maharashtra Co-operative Societies Act, 1960
[Maharashtra Act XXIV of 1961])

24. Nominal, associate and sympathizer member.—

(1) Notwithstanding anything contained in section 22, a society may admit any person as a nominal, associate or sympathizer member.

(2) A nominal member or sympathizer member **shall not be entitled to any share in any form whatsoever in the profits or assets of the society** as such member.

A nominal or sympathizer member **shall ordinarily not have any of the privileges and rights of a member**, but such a member, or an associate member, may, subject to the provisions of sub-section (8) of section 27, **have such privileges and rights and be subject to such liabilities**, of a member, as may be specified in the bye-laws of the society.

THE JALGAON DISTRICT CENTRAL CO-OPERATIVE BANK LIMITED
vs.
UNION OF INDIA ORS

Held :- Sec. 194A(3)(v) grants an exemption from TDS to income credited or paid by the co-operative society to a member thereof or to any other co-operative society. Clause (v) of sub-s. (3) of s. 194A is very lucid and clear in its terms which suggests that the provisions relating to TDS are inapplicable to the income credited or paid by the co-operative society to the member thereof. The word "member" used in this provision is without any words of limitation. The expression "member" is not defined in the IT Act, 1961. A co-operative society has to be established under the provisions of law made by the State legislature. The definition of expression "member" is given under s. 2(19) of the Maharashtra Co-operative Societies Act, 1960. As per the definition, "member" means a person joining an application for registration of a co-operative society, which is subsequently registered or a person duly admitted to membership of a society after registration and includes a nominal, associate or sympathizer member. There is no distinction between duly registered member and nominal, associate and sympathizer member. The impugned circular issued by CBDT, which is in the form of clarification with regard to rights and privileges of a duly registered member and nominal member is outside the scope of s. 119. No doubt, s. 119 generates some power in CBDT. But the power so generated by virtue of s. 119 is required to be utilized in a prescribed manner. CBDT is empowered to issue only administrative instructions to the subordinate authorities for the purpose of proper administration and enforcement of the provisions of the IT Act, 1961.

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THE JALGAON DISTRICT CENTRAL CO-OPERATIVE BANK LIMITED
vs.
UNION OF INDIA ORS

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Under the garb of s. 119 CBDT has crossed its authority. What is not contemplated in exemption clause under s. 194A(3)(v), cannot be imported to deprive the exemption granted to co-operative society by issuing the impugned circular. By impugned circular, the co-operative society cannot be deprived of its right of exemption given under IT Act, 1961. **The CBDT has overstepped its authority and has issued the impugned circular directly in conflict with the provisions contained in s. 194A(3)(v). Sec. 119 does not at all support the action of CBDT. CBDT has no authority to make a crack in the exemption clause contained in s. 194A(3)(v), by issuing the impugned circular. The CBDT cannot usurp the powers of Parliament by virtue of s. 119.** The CBDT, under the garb of s. 119, cannot exercise wider powers than the powers bestowed on it. The CBDT has no power to introduce a substantial change or alteration in the provisions of the IT Act, 1961, by importing the ideas unknown to the IT Act, 1961. The impugned circular, therefore, does not stand to the legal test. The impugned circular No. 9 of 2002, dt. 11th Sept., 2002 is quashed and set aside. Similarly, the letter issued by the ITO, **Jalgaon**, Ward No. 2(3), dt. 9th Oct., 2002, is also quashed and set aside.

Cases Ref To : U.P. Co-op. Cane Union Federation Ltd., Lucknow vs. CIT (1999) 157 CTR (SC) 569 : AIR 1999 SC 1597, Banque Nationale De Paris vs. CIT (1999) 154 CTR (Bom) 579 : (1997) 237 ITR 518 (Bom), CIT vs. Varangaon Co-operative Fruit and Agricultural Produce Sale Society Ltd. Varangaon (IT Appln. No. 20 of 1987 decided on 26th July, 1990) and K.K. Adhikari vs. T.G. Kulkarni 1980 CTJ 241

Applicability of Section 80P of the Income Tax Act, 1961 to Credit Co-operative Societies

CITIZEN CO-OPERATIVE SOCIETY LIMITED
vs.
ASSISTANT COMMISSIONER OF INCOME TAX

(2017) 397 ITR 0001 (SC)

Issue :- with insertion of sub-section (4) by Finance Act, 2006, it was made clear that such deduction should not be admissible to co-operative bank—However, if it was primary agriculture credit society or primary co-operative agriculture and rural development bank, deduction would still be provided—Thus, co-operative banks were now specifically excluded from ambit of Section 80P.

Held :-

23. With the insertion of sub-**section** (4) by the Finance Act, 2006, which is in the nature of a proviso to the aforesaid provision, it is made clear that such a deduction shall not be admissible to a co-operative bank. However, if it is a primary agriculture credit society or a primary co-operative agriculture and rural development bank, the deduction would still be provided. Thus, co-operative banks are now specifically excluded from the ambit of **Section** 80P of the Act.

24. Undoubtedly, if one has to go by the aforesaid definition of 'co-operative bank', the appellant does not get covered thereby. It is also a matter of common knowledge that in order to do the business of a co-operative bank, it is imperative to have a licence from the Reserve Bank of India, which the appellant does not possess. Not only this, as noticed above, the Reserve Bank of India has itself clarified that the business of the appellant does not amount to that of a co-operative bank. The appellant, therefore, would not come within the mischief of sub-**section** (4) of **Section** 80P.

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Commissioner of Income-tax

v.

Jafari Momin Vikas Co-op. Credit Society Ltd.

[2014] 362 ITR 331 (Gujarat)

Held :-

Section 80P of the Income-tax Act, 1961 - Deductions - Income of co-operative societies (Credit co-operative society) - Whether where assessee was not a credit co-operative bank but a credit co-operative society, its claim for deduction under section 80P(2)(a)(i) could not be rejected by invoking exclusion clause of sub-section (4) of section 80P - Held Yes.

Jurisdictional tribunal judgement:

Income-tax Officer, Ward 1(4)

v.

Jankalyan Nagri Sahakari Pat Sanstha Ltd

[2012] 54 SOT 60 (Pune)

14A Disallowances

Maxopp Investment Ltd
402 ITR 640 (SC)

Issue :-The Supreme Court had to consider the question whether a disallowance under section 14A read with Rule 8D can be made where the shares/stocks were purchased of a company for the purpose of gaining control over the said company or as 'stock-in-trade'. However, incidentally income was also generated in the form of dividends as well.

Appellant :- Assesse

AO's Contention:- AO has rejected appellants contention and proceeded to apply Rule 8D, and made consequential disallowance.

Proceedings:-CIT(A) rejected Assesses contention thereby upholding order of AO— Appeal was also dismissed by Tribunal and High Court

Maxopp Investment Ltd

402 ITR 640 (SC)

Held :- (i) In the first instance, it needs to be recognised that as per section14A(1) of the Act, deduction of that expenditure is not to be allowed which has been incurred by the assessee "in relation to income which does not form part of the total income under this Act". Axiomatically, it is that expenditure alone which has been incurred in relation to the income33which is includible in total income that has to be disallowed. If an expenditure incurred has no causal connection with the exempted income, then such an expenditure would obviously be treated as not related to the income that is exempted from tax, and such expenditure would be allowed as business expenditure. To put it differently, such expenditure would then be considered as incurred in respect of other income which is to be treated as part of the total income.

(ii) There is no quarrel in assigning this meaning to section 14A of the Act. In fact, all the High Courts, whether it is the Delhi High Court on the one hand or the Punjab and Haryana High Court on the other hand, have agreed in providing this interpretation to section 14A of the Act. The entire dispute is as to what interpretation is to be given to the words 'in relation to' in the given scenario, viz. where the dividend income on the shares is earned, though the dominant purpose for subscribing in those shares of the investee company was not to earn dividend.

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Maxopp Investment Ltd
402 ITR 640 (SC)

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(iii) We have two scenarios in these sets of appeals. In one group of cases the main purpose for investing in shares was to gain control over the investee company. Other cases are those where the shares of investee company were held by the assessees as stock-in-trade (i.e. as a business activity) and not as investment to earn dividends. In this context, it is to be examined as to whether the expenditure was incurred, in respective scenarios, in relation to the dividend income or not.

(iv) Having clarified the aforesaid position, the first and foremost issue that falls for consideration is as to whether the dominant purpose test, which is pressed into service by the assessees would apply while interpreting Section 14A of the Act or we have to go by the theory of apportionment. We are of the opinion that the dominant purpose for which the investment into shares is made by an assessee may not be relevant. No doubt, the assessee like Maxopp Investment Limited may have made the investment in order to gain control of the investee company. However, that does not appear to be a relevant factor in determining the issue at hand. Fact remains that such dividend income is non-taxable. In this scenario, if expenditure is incurred on earning the dividend income, that much of the expenditure which is attributable to the dividend income has to be disallowed and cannot be treated as business expenditure. Keeping this objective behind Section14A of the Act in mind, the said provision has to be interpreted, particularly, the word 'in relation to the income' that does not form part of total income. Considered in this hue, the principle of apportionment of expenses comes into play as that is the principle which is engrained in Section 14A of the Act. This is so held in Walfort Share and Stock Brokers P Ltd., relevant passage whereof is already reproduced above, for the sake of continuity of discussion, we would like to quote the following few lines therefrom.

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Maxopp Investment Ltd
402 ITR 640 (SC)

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"The next phrase is, "in relation to income which does not form part of total income under the Act". It means that if an income does not form part of total income, then the related expenditure is outside the ambit of the applicability of section 14A.. xxx xxx xxx The theory of apportionment of expenditure between taxable and non-taxable has, in principle, been now widened under section 14 A."

(v) The Delhi High Court, therefore, correctly observed that prior to introduction of Section 14A of the Act, the law was that when an assessee had a composite and indivisible business which had elements of both taxable and non-taxable income, the entire expenditure in respect of said business was deductible and, in such a case, the principle of apportionment of the expenditure relating to the non-taxable income did not apply.

(vi) The principle of apportionment was made available only where the business was divisible. It is to find a cure to the aforesaid problem that the Legislature has not only inserted Section 14Aby the Finance (Amendment) Act, 2001 but also made it retrospective, i.e., 1962 when the Income Tax Act itself came into force. The aforesaid intent was expressed loudly and clearly in the Memorandum explaining the provisions of the Finance Bill, 2001.

(vii) We, thus, agree with the view taken by the Delhi High Court, and are not inclined to accept the opinion of Punjab & Haryana High Court which went by dominant purpose theory. The aforesaid reasoning would be applicable in cases where36shares are held as investment in the investee company, may be for the purpose of having controlling interest therein. On that reasoning, appeals of Maxopp Investment Limited as well as similar cases where shares were purchased by the assessees to have controlling interest in the investee companies have to fail and are, therefore, dismissed.

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Maxopp Investment Ltd
402 ITR 640 (SC)

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(viii) There is yet another aspect which still needs to be looked into. What happens when the shares are held as 'stock-in-trade' and not as 'investment', particularly, by the banks? On this specific aspect, CBDT has issued circular No. 18/2015 dated November 02, 2015.

(ix) This Circular has already been reproduced in Para 19 above. This Circular takes note of the judgment of this Court in Nawanshahar case wherein it is held that investments made by a banking concern are part of the business or banking. Therefore, the income arises from such investments is attributable to business of banking falling under the head 'profits and gains of business and profession'. On that basis, the Circular contains the decision of the Board that no appeal would be filed on this ground by the officers of the Department and if the appeals are already filed, they should be withdrawn.

(x) A reading of this circular would make it clear that the issue was as to whether income by way of interest on securities shall be chargeable to income tax under the head 'income from other sources' or it is to fall under the head 'profits and gains of business and profession'. The Board, going by the decision of this Court in Nawanshahar case, clarified that it has to be treated as income falling under the head 'profits and gains of business and profession'. The Board also went to the extent of saying that this would not be limited only to co-operative societies/Banks claiming deduction under Section80P(2)(a)(i) of the Act but would also be applicable to all banks/commercial banks, to which Banking Regulation Act, 1949 applies.

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Maxopp Investment Ltd
402 ITR 640 (SC)

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(xi) From this, Punjab and Haryana High Court pointed out that this circular carves out a distinction between 'stock-in-trade' and 'investment' and provides that if the motive behind purchase and sale of shares is to earn profit, then the same would be treated as trading profit and if the object is to derive income by way of dividend then the profit would be said to have accrued from investment. To this extent, the High Court may be correct.

(xii) At the same time, we do not agree with the test of dominant intention applied by the Punjab and Haryana High Court, which we have already discarded. In that event, the question is as to on what basis those cases are to be decided where the shares of other companies are purchased by the assessees as 'stock-in-trade' and not as 'investment'. We proceed to discuss this aspect hereinafter.

(xiii) In those cases, where shares are held as stock-in-trade, the main purpose is to trade in those shares and earn profits therefrom. However, we are not concerned with those profits which would naturally be treated as 'income' under the head 'profits and gains from business and profession'. What happens is that, in the process, when the shares are held as 'stock-in-trade', certain dividend is also earned, though incidentally, which is also an income. However, by virtue of Section 10(34) of the Act, this dividend income is not to be included in the total income and is exempt from tax. This triggers the applicability of Section14A of the Act which is based on the theory of apportionment of expenditure between taxable and non-taxable income as held in Walfort Share and Stock Brokers P Ltd. case. Therefore, to that extent, depending upon the facts of each case, the expenditure incurred in acquiring those shares will have to be apportioned.

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Maxopp Investment Ltd
402 ITR 640 (SC)

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(xiv) We note from the facts in the State Bank of Patiala cases that the AO, while passing the assessment order, had already restricted the disallowance to the amount which was claimed as exempt income by applying the formula contained in Rule 8D of the Rules and holding that section 14A of the Act would be applicable. In spite of this exercise of apportionment of expenditure carried out by the AO, CIT(A) disallowed the entire deduction of expenditure. That view of the CIT(A) was clearly untenable and rightly set aside by the ITAT. Therefore, on facts, the Punjab and Haryana High Court has arrived at a correct conclusion by affirming the view of the ITAT, though we are not subscribing to the theory of dominant intention applied by the High Court. It is to be kept in mind that in those cases where shares are held as 'stock-in-trade', it becomes a business activity of the assessee to deal in those shares as a business proposition.

(xv) Whether dividend is earned or not becomes immaterial. In fact, it would be a quirk of fate that when the investee company declared dividend, those shares are held by the assessee, though the assessee has to ultimately trade those shares by selling them to earn profits. The situation here is, therefore, different from the case like Maxopp Investment Ltd. where the assessee would continue to hold those shares as it wants to retain control over the investee company. In that case, whenever dividend is declared by the investee company that would necessarily be earned by the assessee and the assessee alone. Therefore, even at the time of investing into those shares, the assessee knows that it may generate dividend income as well and as and when such dividend income is generated that would be earned by the assessee. In contrast, where the shares are held as stock-in-trade, this may not be necessarily a situation. The main purpose is to liquidate those shares whenever the share price goes up in order to earn profits. In the result, the appeals filed by the Revenue challenging the judgment of the Punjab and Haryana High Court in State Bank of Patiala also fail, though law in this respect has been clarified hereinabove.

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Maxopp Investment Ltd
402 ITR 640 (SC)

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(xv) Having regard to the language of Section 14A(2) of the Act, read with Rule 8D of the Rules, we also make it clear that before applying the theory of apportionment, the AO needs to record satisfaction that having regard to the kind of the assessee, suo moto disallowance under Section 14A was not correct. It will be in those cases where the assessee in his return has himself apportioned but the AO was not accepting the said apportionment. In that eventuality, it will have to record its satisfaction to this effect. Further, while recording such a satisfaction, nature of loan taken by the assessee for purchasing the shares/making the investment in shares is to be examined by the AO.

Godrej & Boyce Mfg. Co. Ltd
394 ITR 449 (SC)

Issue :- S. 14A disallowance has to be made also with respect to dividend on shares and units on which tax is payable by the payer u/s 115-O & 115-R. Argument that such dividends are not tax-free in the hands of the payee is not correct. S. 14A cannot be invoked in the absence of proof that expenditure has actually been incurred in earning the dividend income. If the AO has accepted for earlier years that no such expenditure has been incurred, he cannot take a contrary stand for later years if the facts and circumstances have not changed.

The Supreme Court had to consider two questions arising from the judgement of the Bombay High Court in Godrej & Boyce vs. CIT 328 ITR 81 (Bom):

(a) Whether the phrase "income which does not form part of total income under this Act" appearing in Section 14A includes within its scope dividend income on shares in respect of which tax is payable under Section 115-O of the Act and income on units of mutual funds on which tax is payable under Section 115-R?

(b) Whether bearing in mind the unanimous findings of the lower authorities over a considerable period of time (which were accepted by the Revenue) there could at all be any question of the provisions of Section 14A in the appellant's case?

Godrej & Boyce Mfg. Co. Ltd
394 ITR 449 (SC)

Held :- Re Q (a):

(i) The object behind the introduction of Section 14A of the Act by the Finance Act of 2001 is clear and unambiguous. The legislature intended to check the claim of allowance of expenditure incurred towards earning exempted income in a situation where an assessee has both exempted and non-exempted income or includible or non-includible income. While there can be no scintilla of doubt that if the income in question is taxable and, therefore, includible in the total income, the deduction of expenses incurred in relation to such an income must be allowed, such deduction would not be permissible merely on the ground that the tax on the dividend received by the assessee has been paid by the dividend paying company and not by the recipient assessee, when under Section 10(33) of the Act such income by way of dividend is not a part of the total income of the recipient assessee. A plain reading of Section 14A would go to show that the income must not be includible in the total income of the assessee. Once the said condition is satisfied, the expenditure incurred in earning the said income cannot be allowed to be deducted. The section does not contemplate a situation where even though the income is taxable in the hands of the dividend paying company the same to be treated as not includible in the total income of the recipient assessee, yet, the expenditure incurred to earn that income must be allowed on the basis that no tax on such income has been paid by the assessee. Such a meaning, if ascribed to Section 14A, would be plainly beyond what the language of Section 14A can be understood to reasonably convey.

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Godrej & Boyce Mfg. Co. Ltd
394 ITR 449 (SC)

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(ii) The principle of law in K.P. Varghese (1981) 131 ITR 597 (SC) cannot assist the Assessee in the present case. The literal meaning of Section 14A, far from giving rise to any absurdity, appears to be wholly consistent with the scheme of the Act and the object/purpose of levy of tax on income. Therefore, the well-entrenched principle of interpretation that where the words of the statute are clear and unambiguous recourse cannot be had to principles of interpretation other than the literal view will apply (Commissioner of Income Tax-III vs. Calcutta Knitwears, Ludhiana (2014) 6 SCC 444 (para 31) followed);

CIT
vs.
Essar Teleholdings Ltd
401 ITR 445 (SC)

Section :- Section 14A of the Income-tax Act, 1961, read with Rule 8D of the Income-Tax Rules, 1962

Issue :- Expenditure incurred in relation to income not includible in total income (Applicability of rule 8D) - Whether rule 8D is prospective in operation and cannot be applied to any assessment year prior to assessment year 2008-09

Held :- Held, yes

PCIT
vs.
Tejas Rohitkumar Kapadia

Section :- Section 69A of the Income-tax Act, 1961.

Held **:-** S. 69 Bogus Purchases: Purchases cannot be treated as Bogus if

(a) they are duly supported by bills,

(b) all payments are made by account payee cheques,

(c) the supplier has confirmed the transactions,

(d) there is no evidence to show that the purchase consideration has come back to the assessee in cash,

(e) the sales out of purchases have been accepted &

(f) the supplier has accounted for the purchases made by the assessee and paid taxes thereon.

CIT
vs.
Sunita Dhadda
(Supreme Court)

Section :- Section 143(3)/ 292C of the Income-tax Act, 1961.

Held :- If the AO wants to rely upon documents found with third parties, the presumption u/s 292C against the assessee is not available. As per the principles of natural justice, the AO has to provide the evidence to the assessee & grant opportunity of cross-examination. Secondary evidences cannot be relied on as if neither the person who prepared the documents nor the witnesses are produced. The violation of natural justice renders the assessment void. The Dept cannot be given a second chance.

Mahaveer Kumar Jain

vs.

CIT

(Supreme Court)

It is a fundamental rule of law of taxation that, unless otherwise expressly provided, income cannot be taxed twice. A taxing Statute should not be interpreted in such a manner that its effect will be to cast a burden twice over for the payment of tax on the taxpayer unless the language of the Statute is so compelling that the court has no alternative than to accept it. In a case of reasonable doubt, the construction most beneficial to the taxpayer is to be adopted