

Chapter 1: Introduction

1.1 Overview

Co-operative Institutions

A Co-operative¹ is an autonomous association of persons united voluntarily to meet their common economic, social and cultural needs and aspirations through jointly owned and democratically controlled enterprise. Co-operatives are legally established associations or business enterprises owned and controlled by the members, that, they also serve. The basic feature differentiating Co-operatives from other forms of business ownership is that its primary motive is service to the members rather than making profits.

1.2 Co-operative Societies: Definition, Governing Acts

1.2.1 The formation and working of the Co-operative Societies in India is governed by the Co-operative Societies Act, 1912, a Central Act. Section 4 of the Act defines Co-operative Society as “a society which has in its objectives the promotion of economic interest of its members in accordance with Co-operative principles”. This Act facilitates the formation of Co-operative Societies for the promotion of thrift and self-help among agriculturists, artisans and persons of limited means.

Subsequently, Part IXB was inserted into the Constitution of India by the Constitution (Ninety-seventh Amendment) Act, 2011. It defines the Co-operative Societies as ‘a society registered or deemed to be registered under any law relating to Co-operative Societies for the time being in force in any State’.

Co-operative Societies are further listed under the State List of the Seventh Schedule of the Indian Constitution². The State laws govern the incorporation, regulation and winding up of Co-operative Societies (other than the Multi-State Co-operative Societies that are operating in more than one State) based on the principles of voluntary formation, democratic member control, member-economic participation and autonomous functioning. The respective State Governments and the Registrar of Co-operative Societies (ROCS) appointed by the State monitor and regulate the Co-operative Societies in the States.

1 Source: United Nations website, www.un.org/development/desa/Co-operatives

2 Schedule VII, List II, Item 32 of Constitution of India

A Co-operative Society may be established and registered for the promotion of interest of members in accordance with the Co-operative principles. At least 10 members are required for registering a Co-operative Society. A certificate of registration signed by the Registrar shall be conclusive evidence that the society therein mentioned is duly registered unless it is proven that the registration of the society has been cancelled. The Registrar also classifies the society into classes and sub-classes of societies prescribed in the Governing Acts according to the principal object in the bye-laws.

1.2.2 The incorporation, regulation and winding up of Co-operative Societies operating in more than one state is governed by the Multi-State Co-operative Societies Act, 2002. The federal Co-operative Societies may be classified with reference to the nature of their activities. Not more than one federal Co-operative Society shall be registered in similar and identical objects in same area of operation.

1.3 Co-operative Banks: Definition, Governing Acts

1.3.1 A Co-operative Bank is a Co-operative Society registered or deemed to have been registered under any State or Central Act and is engaged in banking business. The Co-operative Banks are, thus, governed by Central or State regulatory laws governing Single State Co-operative Societies and Multi-State Co-operative Societies in addition to the regulatory laws governing 'Banking', listed as Central subject³ in the Constitution of India. The applicable laws governing the banking activities are:

- a) The Reserve Bank of India Act, 1934;
- b) Part V of the Banking Regulation Act, 1949 as applicable to Co-operative Banks;
- c) The Banking Regulation (Amendment) and Miscellaneous Provisions Act, 2004; and
- d) The Banking Laws (Application to Co-operative Societies) Act, 1965.

1.3.2 The Banking Regulation Act, 1949 was made applicable to Co-operative Banks in 1966 by incorporating Section 56 therein. The important provisions of Banking Regulation Act, 1949, which are applicable to Co-operative Banks, are:

- (a) The Act shall not apply to a Primary Agricultural Credit Society (PACS⁴) and a Co-operative Land Mortgage Bank.

³ List I, Item 45, Schedule VII of the Constitution of India.

⁴ Primary Agricultural Credit Society (PACS) is a rural Co-operative credit institution that operates at district or state level and is part of rural Co-operative Banking segment.

- (b) RBI can cancel a license granted to a Co-operative Bank if the bank closes banking business or the bank does not comply with any conditions imposed by RBI while issuing license.

1.4 Taxability of Co-operative Societies and Co-operative Banks

1.4.1 As per Section 2(19) of the Income Tax Act, 1961 (the Act) 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. A Co-operative Society or Co-operative Bank registered under the Co-operative Societies Act (State or Central Act) is treated as an “assessee” liable to pay income tax under the provisions of the Act and every such Co-operative Society or Co-operative Bank is therefore governed by the provisions of the Act and liable to be assessed to income tax as per the provisions of the Act like any other assessee.

1.4.2 There is no threshold limit for taxability of income in case of Co-operative Society or Co-operative Bank. The incomes are liable to be taxed at slab rates prescribed in the Finance Acts applicable to Co-operative Societies in respective Assessment Years. A Co-operative Society or Co-operative Bank has to file return of income in Form ITR-5 by due date as notified by the Central Board of Direct Taxes (CBDT) for filing of Income Tax Return. Other compliance requirements for Co-operative Societies/ Co-operative Banks under the provisions of the Act include, inter alia, obtaining Permanent Account Number (PAN⁵) and Tax Deduction and Collection Account Number (TAN⁶) registration, payment of advance tax, Tax Deduction at Source provisions including filing of quarterly Tax Deducted at Source (TDS⁷) returns, maintenance of books of accounts and other documents prescribed under section 44AA of the Act; audit under section 44AB of the Act if receipts from business cross specified limits; levy of Alternate Minimum Tax (AMT⁸).

1.5 Why we chose the topic

The Co-operative Sector witnessed a significant growth in terms of number of entities registered as Co-operative Societies and Co-operative Banks as is evident from the graphs below.

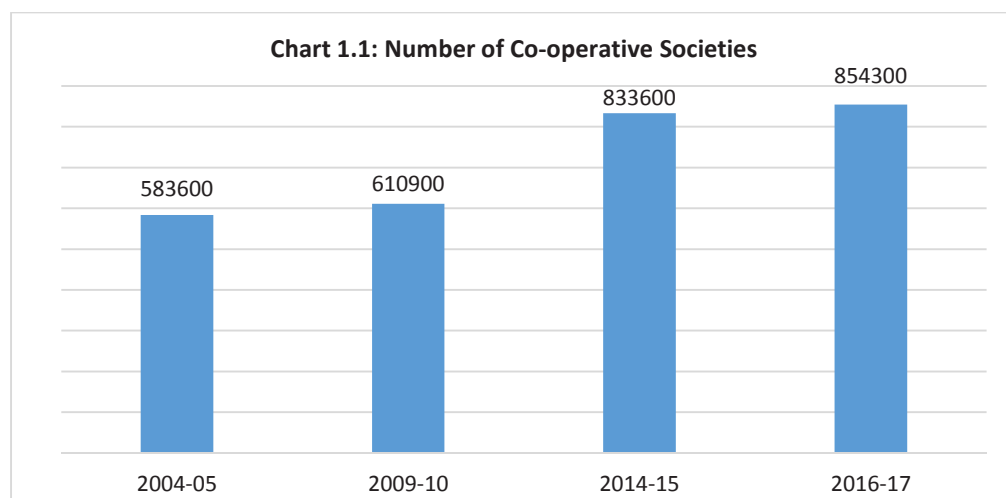
5 Permanent Account Number (PAN) is a unique ten digit alpha numeric number allotted by ITD to any “person” who applies for it.

6 TAN or Tax Deduction and Collection Account Number is a ten digit alpha numeric number required to be obtained by all persons who are responsible for deducting or collecting tax.

7 As per the Income Tax Act, a person (deductor) who is liable to make payment of specified nature to any other person (deductee) shall deduct tax at source and remit the same into the account of the Central Government.

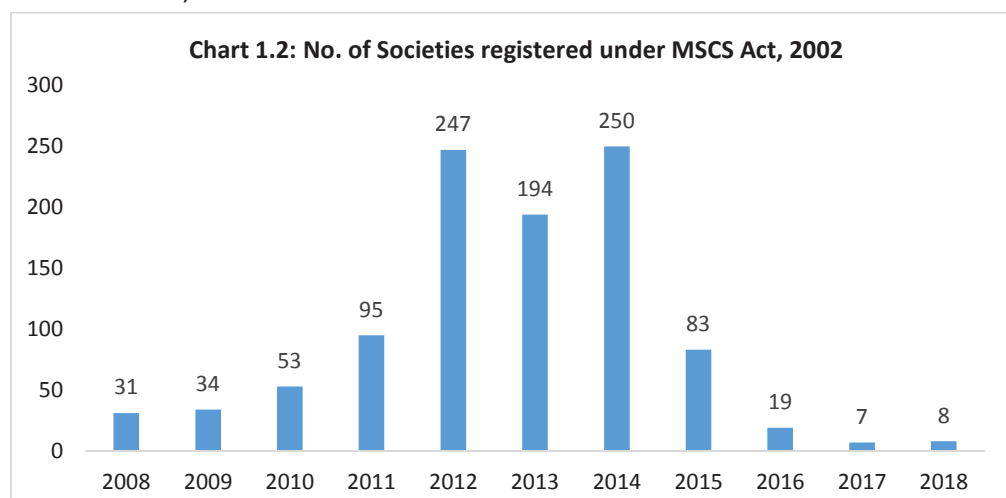
8 Alternate Minimum Tax is minimum tax that is leviable alternative to normal tax under section 115JC of the Act and is applicable to non-corporate taxpayers including Association of Persons (AOPs).

A. **Growth in respect of Co-operative Societies:** During 2009-10 to 2016-17, Co-operative Societies registered a growth of 39.84 per cent.



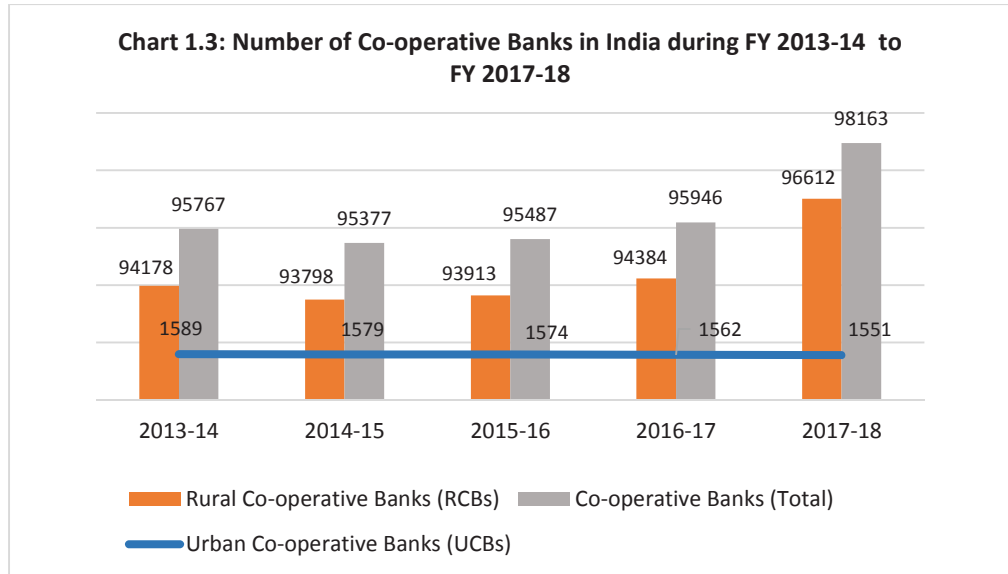
Source: NCUI, Statistical Profile 2018.

B. **Growth in respect of Multi-State Co-operative Societies:** The registration of Multi-State Co-operative Societies was, relatively, high during the years 2012 to 2014, as seen below:



Source: <https://mscs.dac.gov.in/ChartYear.aspx>

C. **Growth of Co-operative Banks:** There was a significant growth in the number of Co-operative Banks post 2014-15. The chart below shows the number of Co-operative Banks in the country during the period between FY 2013-14 to FY 2017-18:



Source: RBI

As mentioned above the Co-operative Sector has witnessed substantial growth both in the number of Co-operative Societies as well as Co-operative Banks. They are subject to tax as per the provisions referred to above. This topic was selected for performance audit with a view to examine the extent of:

- Coverage of Co-operative Societies in Income Tax net;
- Widening and deepening of the tax base; and
- Compliance of the statutory provisions.

1.6 Audit Objectives

The objectives of the performance audit are to examine:

- whether all the entities in the Co-operative Sector are in the tax net and filing income tax returns and are being assessed for levy of due amount of tax;
- the nature and extent of compliance to provisions specific to the assesseees of Co-operative Sector under the Income Tax Act, 1961; and
- the nature and extent of compliance to the general provisions of the Act during assessment process.

1.7 Scope of Audit

The database of returns in respect of the assesseees of Co-operative Sector to be covered in audit was called for from DGIT (Systems) for the FYs 2014-15 to 2017-18. DGIT (Systems) provided Assessing Officer-wise aggregate data and

assessee-wise data of Income Tax Returns (ITRs⁹) assessed during FYs 2014-15 to 2016-17¹⁰ with respect to Co-operative Societies, Co-operative Banks and non-banking finance companies (NBFCs) [2,36,997 records]. The cases having business code 807 (pertaining to NBFCs), exclusively, were excluded to arrive at a population of 1,97,898 records for sample selection of Co-operative Societies and Co-operative Banks. The DGIT(Systems) however, did not provide the status codes¹¹ of the cases shared with audit. The Financial Year (FY)-wise details of 1,97,898 records are given below:

Table 1.1: Details of records shared by DGIT(Systems) for FY 2014-15 to 2016-17

[Amount in ₹Crore]

FY	No of records	Returned Income	Assessed Income	Demand Raised	Amount of Bad and Doubtful Debts	Provision for Bad and Doubtful Debts	Deduction under Section 80P
2014-15	47241	7060.06	28883.23	9121.22	17.82	410.15	3301.36
2015-16	68330	22065.93	38128.69	6709.82	156.35	1387.11	8938.62
2016-17	82327	47267.70	65210.30	5678.52	331.81	2016.77	88495.51

Source: Data provided by DGIT (Systems), ITD

1,97,898 records were analysed and extractions based on audit parameters were segregated area-wise to arrive at a sample detailed in para 1.8 of this chapter.

1.8 Sample Selected and Audited

The sample for this performance audit was derived from the data provided by Income Tax Department (ITD) for period 2014-15 to 2016-17, as per risk assessment carried out by audit. The sample also comprised additional assessment cases finalised during 2017-18 and 2018-19 in respect of PANs selected from the sample derived from ITD data for 2014-15 to 2016-17 and Multi-State Co-operative Societies / Co-operative Banks cases identified from the list of Multi State Co-operative Societies available on the MSCS website.

9 Income Tax Return (ITR) is a form in which the taxpayers file information about his incomes earned and tax applicable to the Income Tax Department.

10 DGIT(Systems) furnished the aggregate data and assessee-wise data of ITRs pertaining to Co-operative Sector that were assessed during FY 2017-18, that was sought before commencement of field audit for planning purposes, towards completion of field audit (September 2019).

11 Status Code – Status codes are used by the Income Tax Department to identify the status of the taxpayer, being either Individual, Hindu Undivided Family (HUF), Firm, Local Authority, Co-operative Bank, Co-operative Society, Any other AOP or BOI, Public Company, Private Company or Others. Status Code for Co-operative Bank is 03 and Co-operative Society is 04.

Details of cases selected for audit in respect of all States/Regions¹² are tabulated below:

Table 1.2: Sample Selection

Sl. No.	Sample selected	No. of cases
1	Number of PCsIT/CsIT selected	291
2	Number of Assessment Charge selected	1726
3	Sample size	9282 ¹³
4	Number of cases not produced	412
5	Number of cases in data furnished by ITD which did not fall under the category of a Co-operative Society or Co-operative Bank.	400 ¹⁴
6	Total (4+5)	812
7	Number of cases covered in the Performance Audit (3-6)	8470

Apart from the above cases covered in the performance audit, 128 audit observations in respect of Co-operative Societies and Co-operative Banks noticed during the compliance audits have also been incorporated separately in Chapter 4 of this report.

1.9 Constraints/ Non-production of Records

Audit had called for 9,282 sample case records (including 81 cases of MSCS) pertaining to Co-operative Societies and Co-operative Banks from 1,726 Assessment Charges for audit scrutiny. Out of chosen sample, 412 (4.44 per cent) cases were not produced to Audit.

ITD has assigned specific Status Code to Co-operative Societies (04) and Co-operative Banks (03) for distinct classification and codification of the assessee pertaining to Co-operative Sector which is captured through ITRs filed by the assessee. The status code of the assessee-wise detailed data of Co-operative Societies and Co-operative Banks was not furnished to audit although the codes are required to be captured through ITD system. As such, focussed risk assessment for Co-operative Societies and Co-operative Banks, separately, could not be carried out. ITD has not furnished any reasons for not providing Status Code details in respect of assessee-wise detailed data of Co-operative Societies and Co-operative Banks (July 2020).

1.10 Profile of selected sample

The sample selected consisted of around 24.7 per cent of cases selected from the state/ region of Maharashtra. Other major states/ regions represented in

12 Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand, West Bengal

13 Includes 81 MSCS cases

14 These cases comprised assessments of assessee with PAN registration status of Company, Local Authority, Trust or AOP but not registered as Co-operative Society or Co-operative Banks.

the selection were Gujarat, Kerala, Karnataka and Uttar Pradesh & Uttarakhand constituting 9.8 *per cent*, 9.0 *per cent*, 7.9 *per cent* and 7.6 *per cent* of the sample respectively. Selections were made from all regions/ states. Region-wise/ state-wise distribution of audit sample is at Appendix 1.

Based on availability of details of nature of business/ activity as per the assessment records audit found that around 59.8 *per cent* of the assesseees in Co-operative Sector were engaged in banking, credit and financial services (including PACS) followed by trading (8.4 *per cent*), sugar (5 *per cent*) and housing (4.7 *per cent*). Details are in Appendix 2.

The selected assesseees included assesseees with PAN registration status of Association of Persons(Trust) [AOP Trust], Artificial Juridical Person (AJP), Company, Firm, Local Authority or Body of Individuals (BOI) besides the status of AOPs. While 78.4 *per cent* of the assesseees were registered with the ITD as AOP, 2.6 *per cent* were registered as BOI and remaining 19 *per cent* were registered as non-AOP/BOI viz. Trust, AJP, Firm, Local Authority and Company.

In 96.9 *per cent* of the cases examined in audit, the returns were filed through ITR-5. In rest of the cases¹⁵, ITR 2 (2 cases), ITR 2D (15 cases), ITR 4 (18 cases), ITR 6 (13 cases) and ITR 7 (21 cases) were used by the assesseees to file their returns.

1.11 Acknowledgement

Audit acknowledges the cooperation of the ITD in providing necessary data/ records/ information and facilitating the conduct of this performance audit. At the start of this performance audit, an Entry Conference was held with the CBDT/ ITD on 6 March 2019 wherein audit objectives, scope of audit and main focus areas of the performance audit were explained. Draft performance audit report was first issued to the Ministry/ CBDT on 21 May 2020 for their comments. Post receipt of the CBDT's response in July 2020, an Exit Conference was held with the CBDT on 16 July 2020 to discuss audit findings and audit recommendations vis-à-vis their comments. Revised report, incorporating the response of CBDT and the exit conference discussion, was issued to the Ministry/ CBDT on 19 August 2020. Response to the revised report was received on 1 September 2020. The results of the discussion, the CBDT's comments and the audit comments have been duly incorporated in the performance audit report.

¹⁵ In the remaining 16 cases (0.19 *per cent*) return was not filed and in 177 cases (2.09 *per cent*) the information on ITR form could not be ascertained.