

Chapter 3: Compliance to Tax provisions specific to Co-operative Societies and Co-operative Banks

The performance audit envisaged to examine the nature and extent of compliance to provisions specific to the assessee of Co-operative Sector under the Act. The Co-operative Societies engaged in specified activities are eligible to claim deduction on specified income as per provisions under section 80P of the Act. Section 80P(2) of the Act specifies that the incomes earned by Co-operative Societies engaged in types of activities specified under this Act on which claim of deduction under section 80P of the Act is admissible. While examining the allowability of claim of deduction specific to Co-operative Societies the Assessing Officers are required to examine the fulfilment of conditions specified under the Act while also determining their eligibility based on adherence to the principles of mutuality⁴⁹.

The allowance of deduction to entities engaged in banking and financial business on account of provision of bad and doubtful debts and in respect of special reserve created and maintained by a specified entity is regulated by sections 36(1)(viia) and 36(1)(viii) of the Act. Also, Co-operative Societies engaged in manufacture of sugar are entitled to claim deduction on expenditure incurred for purchase of sugarcane under section 36(1)(xvii) of the Act. Assessing Officers are required to examine the claims of these deductions while completing the assessments.

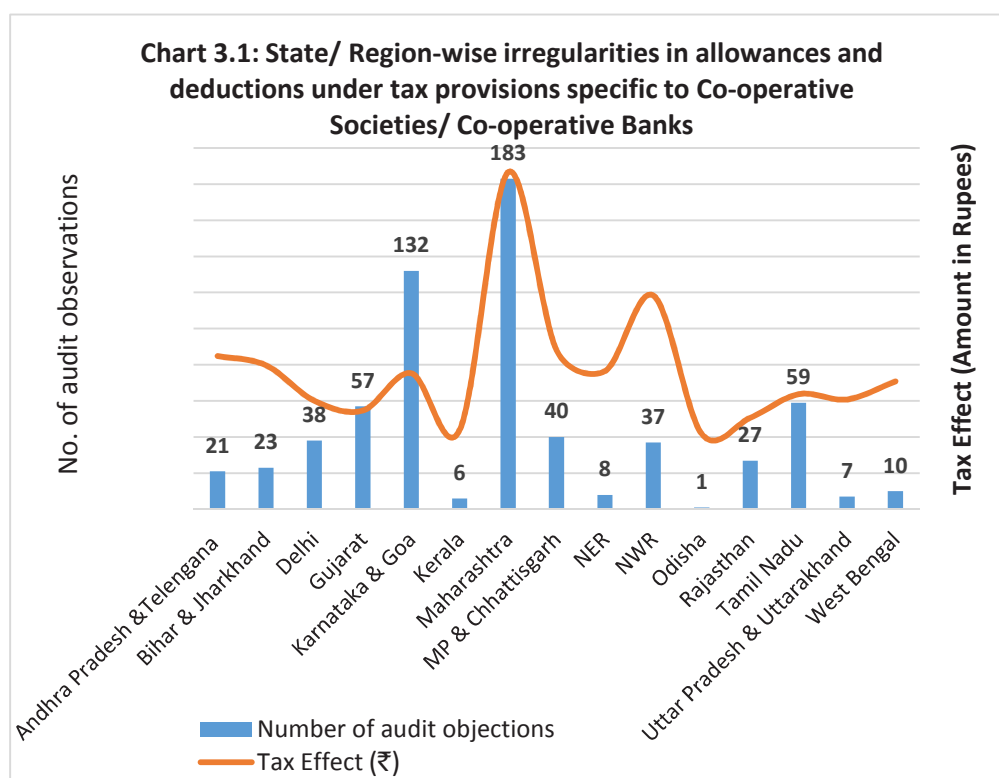
Paras 3.2 to 3.7, 3.11, 3.12 and 3.13 of this Chapter discuss the extent of compliance to provisions under sections 80P, 36(1)(viia), 36(1)(viii) and 36(1)(xvii) of the Act, respectively, as determined by the Assessing Officers during assessment of claims made by assessee. These paras are followed by details and illustration of audit findings noticed during examination of such cases that were subjected to generic checks under the Act and some specific checks as per risk assessment carried out by audit. The assessment particulars of cases subjected to specific checks are discussed in paras 3.8, 3.9 and 3.10 of this Chapter. Audit examination of assessments of Co-operative Societies and Co-operative Banks revealed that the verification mechanism by the Assessing Officers was inadequate in determining adherence to the principles of mutuality and in ensuring fulfilment of the conditions underlying the provisions under the Income Tax Act resulting in allowance of inadmissible claims on ineligible incomes or to ineligible assessee. The instances of

⁴⁹ Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and in this respect have no dealings or relations with any outside body, then any surplus returned to those persons cannot be regarded as profits, which are chargeable to tax [CIT vs Bankipur Club Ltd. 226 ITR p. 97 (SC)].

non-compliance to above-mentioned provisions specific to Co-operative Societies and Co-operative Banks are discussed in this Chapter.

3.1 Profile of irregularities in allowances and deductions under tax provisions specific to Co-operative Societies and Co-operative Banks

The State/ region-wise details of irregularities in allowances and deductions under tax provisions specific to Co-operative Societies and Co-operative Banks noticed during the performance audit and included in this chapter is depicted in Chart 3.1 given below.



Audit noticed instances of irregularities (22.65 per cent of irregularities) in respect of assesseees registered as AJP, AOP(Trust), BOI, Firms, Local Authority and Company. Thus, while the sample contained 18.98 per cent of these cases, the irregularities in respect of these cases were in higher proportion. It is worth noting that the assesseees registered as AJP, BOI, Company, Firm, Local Authority and Trust cannot be assessed as Co-operative Societies. Further, the CBDT has also stated (July 2020) that ‘for the purpose of Income Tax Act, 1961, Co-operative Societies are treated as Association of Persons’. ITD may review the PAN registration status of the assesseees filing income tax returns as Co-operative Societies/ Co-operative Banks to ensure uniformity in PAN registration category of similar class of assesseees registered as taxpayers with ITD and to facilitate effective monitoring of tax compliance by entities in Co-operative Sector.

The section-wise details of irregularities noticed in audit are depicted in Table 3.1 below:

Table 3.1: Irregularities in allowance and deductions under specific sections applicable to Co-operative Societies/ Co-operative Banks

Section of Income Tax Act under which irregularities in allowance of deductions noticed in audit	No. of audit objections	Tax Effect (Amount in ₹ crore)
36(1)(viia)	118	375.20
36(1)(viii)	8	14.01
36(1)(xvii)	19	107.75
80P(2)(a)(i)	115	49.82
80P(2)(a)(ii)	1	0.08
80P(2)(a)(iv)	11	1.16
80P(2)(a)(vi)	2	0.13
80P(2)(a)(vii)	3	0.58
80P(2)(d)	367	145.64
80P(2)(e)	5	0.12
Grand Total	649	694.50

Out of 649 cases of irregularities in assessment of claims and deductions, under tax provisions specific to assessee of Co-operative Sector, the occurrence of errors was relatively higher, in deductions allowed under section 80P(2)(d), 80P(2)(a)(i) and 36(1)(viia) of the Act at 56.6 per cent, 18.2 per cent and 17.7 per cent, respectively. This indicated higher risk of non-compliance in respect of these sections. ITD may review the reasons underlying such irregularities in assessments with greater emphasis on these provisions of the Act to ensure allowance of benefits to eligible assessee on eligible incomes and genuine claims only.

As seen from the activity-wise details of assessments of Co-operative Societies/Co-operative Banks, audit noticed 68.7 per cent of irregularities in assessments of assessee engaged in banking, credit and financial services. This was followed by 6.0 per cent, 5.4 per cent, 5.4 per cent and 4.0 per cent of irregularities in Co-operative Societies engaged in trading, housing, manufacture of sugar and dairy business, respectively. ITD may review the reasons underlying irregularities in allowing deduction under section 80P and 36(1)(viia) of the Act with greater emphasis on the banking, credit and financial services sectors to ensure correct allowance of deductions under the Act.

Of 649 cases where audit noticed mistakes in allowance of deduction, 86.4 per cent of cases (561) were assessed under scrutiny viz. section 143(3) of the Act. Of 561 scrutiny assessment cases, in 380 cases the scrutiny was complete, in 92 it was limited, in three cases it was manual whereas in remaining 86 cases the details of type of scrutiny were not ascertainable. Further, audit observed that out of 453 cases where details of parameters for

selection were available in the assessment records, in 274 cases involving claim and allowance of deduction of ₹ 794.42 crore and ₹ 760 crore, respectively under section 80P of the Act the criteria for selection of case for examination was on account of 'Large deductions claimed under Chapter VI-A' which also includes section 80P of the Act. Thus, audit noticed further irregularities inspite of these assessments having been subjected to detailed examination by the Assessing Officers based on several risk parameters. These instances of incorrect assessments point towards inadequate level of examination of eligibility of incomes and admissibility of claims during assessment.

ITD may consider linking activity classification or nature of business or business codes of Co-operative Society and the status code of assessee with the sub-section of 80P of the Act under which deduction is claimed by assessee at the stage of filing of income tax return to ensure allowance of deduction to eligible assessee only and to minimise possibility of ineligible claims. Linking of activity code and status code with sub-section of 80P of the Act would also enable assessment of impact of deductions in Co-operative Sector besides facilitating effective monitoring of claims. Further, ITD may review the PAN registration status of the assessee claiming deduction admissible to Co-operative Societies to ensure allowance of claims to eligible assessee only.

3.2 Deduction to Co-operative Societies under section 80P(2)(a)(i) of the Act

Section 80P(2)(a)(i) of the Act, provides deduction on Income from banking business or for Income from providing credit facilities to its Members. In the case of a Co-operative Society providing credit facilities to its members, the whole of the amount of profits and gains from such business are deductible. From the assessment year 2007-08 onwards, deduction under Section 80P of the Act is not available to any Co-operative Bank. Further, CBDT has clarified⁵⁰ that Regional Rural Banks are not eligible for deduction under Section 80P of the Act. A PACS or a Primary Co-operative Agricultural and Rural Development Bank will continue to claim the benefit of deduction under Section 80P of the Act. The meaning of Credit facilities and term Members for the purpose of claim of deduction under section 80P(2)(a)(i) of the Act have been subjected to several litigations.

3.2.1 Audit examined 1721 cases⁵¹ of claims of deduction under section 80P(2)(a)(i) of the Act admissible to Co-operative Credit Societies to ascertain whether the assessment of incomes on which deduction is claimed is being done correctly and uniformly by the Assessing Officers.

⁵⁰ CBDT Circular No. 6/2010, dated September 20, 2010

⁵¹ AP&TS, Bihar, Delhi, Gujarat, Jharkhand, Karnataka & Goa, Kerala, Maharashtra, Madhya Pradesh & Chhattisgarh, NWR (Chandigarh, Haryana, Himachal Pradesh, Jammu & Kashmir and Punjab), Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh, West Bengal & Sikkim.

- a. Audit found that out of 1,721 cases involving claim of deduction of ₹ 7,038.39 crore, in 1,507 cases (87.56 per cent) the assesseees were eligible to claim deduction amounting to ₹ 5,550.62 crore on income from carrying on banking business for its members or for providing credit facilities to its members as specified under section 80P(2)(a)(i) of the Act whereas in 192 cases (11.16 per cent) involving claim of deduction of ₹ 1,461.74 crore under section 80P(2)(a)(i) of the Act the assesseees were not eligible for the same. In the remaining 22 cases (1.28 per cent) the eligibility of the claims allowed under section 80P(2)(a)(i) of the Act could not be ascertained from the available records.

Table 3.2: Claims of deduction under section 80P(2)(a)(i) of the Act

Eligibility of Claims made under section 80P(2)(a)(i) of the Act	No. of cases where deduction claimed under section 80P(2)(a)(i) of the Act	Amount of deduction claimed under section 80P(2)(a)(i) of the Act (₹ in crore)
Eligible	1507	5550.62
Ineligible	192	1461.74
Not Ascertainable	22	26.03
Total	1721	7038.39

- b. Audit found that out of 1,721 cases, in 1,356 cases (78.79 per cent) the primary objective of the Co-operative Societies was to provide loans and credit facilities to its members whereas in 91 cases⁵² (5.29 per cent) providing loans and credit facilities to members was not the primary objective. Of 1,356 cases, in 83 cases although the Co-operative Societies had claimed deduction of ₹ 83.81 crore under section 80P(2)(a)(i) of the Act, they were not extending credit facilities to their members. In 74 cases out of these 83 cases the Assessing Officers had not examined the fulfilment of conditions specified under section 80P(2)(a)(i) of the Act while allowing deduction of ₹ 79.76 crore.

3.2.2 Audit, further, noticed 115 cases⁵³ (6.7 per cent of 1,721 cases) in 12⁵⁴ states/ regions out of cases examined in audit where the Assessing Officers had incorrectly allowed deductions to Co-operative Societies under section 80P(2)(a)(i) of the Act resulting in under assessment of income of ₹ 119.98 crore and short levy of tax of ₹ 49.82 crore.

52 In the remaining 278 cases (16.19 per cent) involving claim of deduction of ₹ 857.22 crore it was not ascertainable from records whether primary objective of the assessee was to provide loans and credit facilities to its members.

53 The audit objections include irregularities noticed in audit with respect to cases subjected to generic checks and (as discussed in para 3.1.1) and those subjected to specific checks (as discussed in para 3.8 and para 3.10 of this chapter).

54 Andhra Pradesh & Telangana, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North West Region, Odisha, Tamil Nadu, West Bengal

Of 115 cases where audit noticed mistakes in allowance of deduction, 93 per cent of cases (viz. 107 cases) were assessed under scrutiny viz. section 143(3) of the Act. Of 95 cases, where information on type of scrutiny was available, in 69 cases the scrutiny was complete and in 26 it was limited. Although the cases were selected for examination based on risk parameter of large deduction claimed under section 80P of the Act, audit noticed mistakes involving incorrect allowance of deduction under section 80P(2)(a)(i) of the Act. These instances of incorrect assessments point towards inadequate examination of eligibility of incomes and admissibility of claims during assessment.

The irregular allowance of deduction under section 80P(2)(a)(i) of the Act was on account of interest earned from non-members of Co-operative Society, interest earned from nominal members besides primary members, income from service charges, income earned from commission and miscellaneous fees etc. Two cases are illustrated below:

Box 3.1

Illustration of Incorrect allowance of deduction under section 80P(2)(a)(i) of the Act

a) Charge: PCIT-Kozhikode

Assessment Year: 2016-17

The assessee, a PACS, filed its ITR in October 2016 with NIL income. The scrutiny assessment of the assessee was completed in December 2018 at NIL income. Audit noticed that scrutiny assessment of the assessee for the AY 2015-16 was passed in December 2017 by disallowing deduction under section 80P of the Act on the grounds of lack of principle of mutuality and also on disallowing provisions on different expenditures. But, while passing order for the AY 2016-17 claim under section 80P of the Act was not disallowed. No uniform stand was taken during the two assessment years. This had resulted in irregular allowance of deduction of ₹ 10.86 crore under section 80P of the Act involving tax effect of ₹ 4.54 crore. Reply of the ITD is awaited (February 2020).

b) Charge: PCIT-Cuttack

Assessment Year: 2015-16

The assessee is a Co-operative Bank and derives its income from banking activity. Summary processing under section 143(1) of the Act was done in December 2015 with NIL income. But, scrutiny of ITR-5 revealed that the assessee had claimed deduction of ₹ 5.97 crore under section 80P of the Act. As per amended provisions of section 80P of the Act applicable with effect from 01.04.2007 no deduction under section 80P of the Act was

allowable to Co-operative Banks. This had resulted in irregular allowance of deduction of ₹ 5.97 crore under section 80P of the Act involving tax effect of ₹ 2.23 crore. ITD accepted the audit observation (July 2019) and stated that remedial action was being taken.

3.2.3 Non adherence to the principles of mutuality

The principles of mutuality, though not defined under the Act, have been reiterated in the several judicial rulings⁵⁵.

The 97th Constitutional Amendment (2011) mandated State Regulatory Acts to make provisions to ensure functioning of the Co-operative Societies on the principles of voluntary formation, democratic member control, member's economic participation and autonomous functioning. The Apex Court has reiterated fulfilment of these conditions to satisfy the test of the principle of mutuality on various occasions⁵⁶. Thus, the law and the judicial pronouncements make it clear that the credits extended to associate members and nominal members do not meet the Co-operative principles and hence do not satisfy the principle of mutuality. Therefore, deduction under section 80P(2)(a)(i) of the Act should be restricted to the regular members, excluding the nominal and associate members. Further, if a society carries on some activities based on mutuality and other activities not based on mutuality, then the concept would apply to only those activities, which are mutual.

Audit examined 412 cases of credit Co-operative Societies in Karnataka, in light of the above judgements as well as the threshold stipulated in the regulatory acts for admitting members as Associate Members. Audit observed that in 83 cases, as detailed below, the assessing officers had allowed the deduction under section 80P of the Act, without subjecting them to the test of mutuality, leading to short levy of ₹20.95 crore. Further, 35 similar cases involving allowance of deduction of ₹34.67 crore under section 80P of the Act, where tests of mutuality had not been applied are pending with various appellate authorities. The deficiencies in assessments in respect of the credit Co-operative Societies are discussed below:

- a) Audit noticed that in 31 cases (24 distinct assesseees), assesseees have claimed deduction under section 80P(2)(a)(i) of the Act for income from

55 *Commissioner of Income Tax, Bihar v. Bankipur Club Ltd.*, (1997) 226 ITR 97 (SC); *Bangalore Club v. Commissioner of Income Tax and Another*, (2013) 350 ITR 509 (SC); *The Citizen Co-operative Society vs ACIT (2017) 397 ITR 1 (SC)*

56 *Commissioner of Income Tax, Madras v/s Kumbakonam Mutual Benefit Fund Limited* decided on 07 May 1964 53 ITR 241 (SC); *Indian Tea Planters' Association Vs. CIT* 82 ITR, p.322 (Cal.); *Bangalore Club vs Commissioner Of Income Tax (Supreme Court)*, CIVIL APPEAL NO. 125 OF 2007, Dated – 14 January, 2013; *The Citizen Co-Operative Society Limited v. ACIT (2017) 397 ITR 1 (SC)*

credits extended to nominal and associate members beyond the threshold prescribed by the regulatory acts, which have been allowed by the Assessing Officers. Thus, the Assessing Officers were either not examining the fulfilment of the principle of mutuality or continuing to treat the nominal and associate members on par with the regular members, in violation of the law and the judicial pronouncements.

- b) Audit noticed that in 81 cases (61 distinct assesseees) of credit Co-operative Societies extending credit to members as well as others, the Assessing Officers had equated them with Co-operative Banks as being in lending business and disallowed the deductions claimed under section 80P(2)(a)(i) of the Act, in full, rather than restricting the disallowance to the portion pertaining to external lending. Twenty-nine of these cases are pending with various appellate authorities.
- c) There seems to be lack of clarity amongst the Assessing Officers as to whether the societies registered under the Karnataka Souharda Sahakari Act are eligible for deductions under section 80P of the Act, in spite of the clarification furnished by the ROCS and the rulings of ITAT⁵⁷ that Co-operatives registered under the Karnataka Souharda Sahakari Act are also eligible to claim deduction. As such, ITD continued to disallow deduction under section 80P of the Act in such cases. In six cases of Credit Societies registered under the Karnataka Souharda Sahakari Act the disallowance of deduction amounting to ₹ 12.41 crore under section 80P of the Act was incorrect and cases were pending before the appellate authorities.

3.3 Deduction to Co-operative Societies under section 80P(2)(a)(iv) of the Act

Under section 80P(2)(a)(iv) of the Act a Co-operative Society is eligible for deduction of the whole of income from the purchase of agricultural implements, seeds, livestock or other articles intended for agriculture for the purposes of supplying them to its members.

3.3.1 Audit examined 79 cases⁵⁸ to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(a)(iv) of the Act.

Audit, noticed 11 cases in two⁵⁹ states out of 79 cases examined where the Assessing Officers had allowed deductions for profit earned from retail trading rather than distribution of agricultural implements. This had resulted in under assessment of income of ₹ 2.79 crore and short levy of tax of ₹ 1.16 crore.

57 Udaya Souharda Credit Co-operative Society Ltd. vs. CIT (ITA No. 2831/Bang/2017, August 2018) [ITAT Bangalore]

58 AP&TS, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, Tamil Nadu and West Bengal.

59 Goa, Karnataka

3.4 Deduction to Co-operative Societies under section 80P(2)(a)(vi) of the Act

Income from the activity of collective disposal of the labour of its members is deductible under Section 80P(2)(a)(vi) of the Act. This section has been introduced mainly for the labour Co-operative Societies. These societies consist of the persons who are offering their services as labour through it. The labour can be manual or some technical or other similar services. As per Orissa High Court ruling⁶⁰ Income from the activity of collective disposal of the labour of its members is deductible under section 80P(2)(a)(vi) of the Act.

3.4.1 Audit examined 41 cases to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(a)(vi) of the Act.

- a. Audit found that in 38 cases⁶¹ deduction amounting to ₹ 6.48 crore was claimed under section 80P(2)(a)(vi) of the Act on income of ₹ 56.71 crore from collective disposal of labour through utilisation of actual labour of its members. In 28 cases⁶² out of these 38 cases, the Assessing Officers had allowed entire claim of deduction of ₹ 6.48 crore under section 80P(2)(a)(vi) of the Act on income earned from collective disposal of labour through utilisation of actual labour of its members. In one case⁶³, the Assessing Officer had partially allowed the claim of deduction of ₹ 0.20 crore out of total claim of ₹ 0.63 crore. In eight⁶⁴ cases the Assessing Officers had disallowed entire claim of deduction of ₹ 6.66 crore claimed under section 80P(2)(a)(vi) of the Act on income from collective disposal of labour through utilisation of actual labour of its members.
- b. Audit found that in 2 cases⁶⁵ where deduction was claimed under section 80P(2)(a)(vi) of the Act on income of ₹ 1.04 crore from activity of collective disposal of labour in cases where supervision of work in field was done by paid employees, the Assessing Officer had allowed deduction of ₹ 0.65 crore in one case while in another case the entire claim of deduction of ₹ 0.39 crore was disallowed under section 80P(2)(a)(vi) of the Act.
- c. Audit found one case⁶⁶ where deduction of ₹ 0.46 lakh claimed under section 80P(2)(a)(vi) of the Act was allowed on income from activity of collective disposal of labour in cases where not only members but also

60 Nilagiri Engineering Co-op Society Ltd. v. CIT [1994] 208 ITR 326 (Orissa)

61 AP&TS, Bihar, Madhya Pradesh, Maharashtra, Odisha, Gujarat, Kerala, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

62 AP&TS, Gujarat, Kerala, Maharashtra, Odisha, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal

63 AP&TS, Maharashtra

64 AP&TS, Bihar, Madhya Pradesh, Odisha and Tamil Nadu

65 Odisha

66 West Bengal

a large number of non-members were contributing to collective disposal of labour.

The Assessing Officers took differential stand while assessing eligibility of claim of deduction under section 80P(2)(a)(vi) of the Act on similar incomes such as income earned from collective disposal of labour through utilisation of actual labour of its members and income from activity of collective disposal of labour in cases where supervision of work in field was done by paid employees. The allowability of claims on such incomes needs to be examined to ensure uniformity of assessments in similarly placed cases.

3.4.2 Audit, further, noticed two cases in Karnataka out of 41 cases examined where the Assessing Officers had incorrectly allowed deductions for the collective disposal of the labour of its members. This had resulted in under assessment of income of ₹ 0.34 crore and short levy of tax of ₹ 0.13 crore. One case is illustrated below

Box 3.2

Illustration of Incorrect allowance of deduction under section 80P(2)(a)(vi) of the Act

Charge: PCIT- 4, Bengaluru

AY: 2015-16

It was observed that the membership comprised 595 regular members (defence personnel and ex-servicemen or their spouses), 223 associate members (from the same fraternity as above but resident outside Karnataka) and 275 nominal members (any person or organisation having/intending to have business dealings with the society). Only a few members from all three categories were deployed as security personnel. As such, only a limited number of members were contributing to labour as against collective disposal of labour envisaged by the Act and the assessee was not entitled to claim deduction under section 80P (2)(a)(vi) of the Act. This had resulted in under assessment of income of ₹ 0.19 crore and short levy of tax of ₹ 0.08 crore.

3.5 Deduction to Co-operative Societies under section 80P(2)(a)(vii) of the Act

Section 80P(2)(a)(vii) of the Act envisages that in the case of an assessee, being a Co-operative Society, where the gross total income includes any income from fishing or allied activities (catching, curing, processing, preserving, storing or marketing of fish or the purchase of materials and equipment in connection therewith for the purpose of supplying them to its members) the whole of the amount of profits and gains of business shall be deducted, provided the rules and byelaws of the society restrict the voting rights to the individuals who carry on fishing or allied activities.

3.5.1 Audit examined 12 cases⁶⁷ to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(a)(vii) of the Act.

a. Purchase of material and equipment for fishing and allied activities:

Audit found that in 12 cases⁶⁸ deduction of ₹ 9.47 crore was allowed based on claim made under section 80P(2)(a)(vii) of the Act on income of ₹ 15.16 crore earned by assessee Co-operative Societies from fishing and allied activities. Audit noticed that in three cases⁶⁹ involving claim of deduction of ₹ 5.33 crore purchase of materials and equipment for fishing and allied activities were made for supply to its members whereas in four cases⁷⁰ involving claim of deduction of ₹ 1.88 crore the purchases were not made for supply to its members as shown in table given below. In three cases⁷¹ involving claim of ₹ 6.56 crore no purchases were made as per books of accounts for sale to members. In remaining two cases⁷² involving claim of ₹ 1.39 crore the details of purchases made for fishing activities could not be ascertained from available records.

Table 3.3: Claim of Deduction under section 80P(2)(a)(vii) of the Act.

(₹ in crore)

Claim of deduction made under section 80P(2)(a)(vii) of the Act			Purchase of materials and equipment (for fishing and allied activities) made for supplying to its Members		Purchase not made for supplying to its Members		
No. of cases	Amount of deduction claimed	Amount of deduction allowed	No. of cases	Amount of deduction claimed	No. of cases	Amount of deduction claimed	Amount of deduction allowed
12	15.16	9.47	3	5.33	4	1.88	1.32

67 AP&TS, Delhi, Gujarat, Madhya Pradesh, Karnataka and West Bengal

68 AP&TS, Delhi, Gujarat, Madhya Pradesh, Karnataka and West Bengal

69 Gujarat, Madhya Pradesh, Karnataka.

70 AP&TS, Karnataka, West Bengal.

71 Delhi

72 Karnataka

- b. **Allowance of deduction on income from fishing and allied activities:** Audit found that in six cases⁷³ out of 12 cases, entire claim of deduction of ₹ 7.54 crore was allowed under section 80P(2)(a)(vii) of the Act on income from fishing and allied activities. Of these, in two cases involving claim of deduction of ₹ 4.84 crore the purchases of materials and equipment (for fishing and allied activities) were made for the purpose of supplying to its members, in two cases deduction of ₹ 1.31 crore was irregularly allowed (as discussed in para 3.5.2) where purchases were not for supply to Members whereas in remaining two cases involving claim of deduction of ₹ 1.39 crore the same could not be ascertained. In 5 cases out of 12, claim of deduction of ₹ 1.97 crore was partially allowed against total claim of ₹ 7.22 crore whereas in one case entire claim of ₹ 0.44 crore was disallowed as deduction was claimed on ineligible income i.e. income from sale of bio-diesel.
- c. **Voting rights of members:** The proviso below sub- section (vii) of section 80P of the Act provides that the deduction shall be available only to the societies subject to the conditions that the rules and bye-laws of the society restrict the voting rights to the specified classes of its members. Of 12 cases involving claim of deduction under section 80P(2)(a)(vii) of the Act, in four cases⁷⁴ involving claim of deduction of ₹ 1.92 crore the voting rights were restricted to following classes of its members viz. the individuals who carry on fishing or allied activities, the Co-operative Credit Societies which provide financial assistance to the society and the State Government. In 3 cases involving claim of ₹ 1.44 crore the voting rights were not restricted to Members whereas in the remaining five cases the allocation of voting rights within the Co-operative Societies could not be ascertained from the records.

3.5.2 In three cases in Karnataka (Pr.CIT, Mangalore) audit noticed that deduction under section 80P(2)(a)(vii) of the Act was extended to the fisherman's Co-operative Societies even though the societies did not restrict voting rights to the individuals carrying on fishing or allied activities. The incorrect allowance had resulted in under assessment of income of ₹1.44 crore and short levy of tax of ₹0.58 crore. One case is illustrated below:

73 Gujarat and Karnataka.

74 Delhi(3) and Karnataka(1)

Box 3.3**Illustration of Incorrect allowance of deduction under section 80P(2)(a)(vii) of the Act****a) Charge: PCIT, Mangalore****AY : 2015-16**

The scrutiny assessment of the assessee Co-operative Society was concluded during July 2017 accepting the returned income, while allowing deduction of ₹ 0.96 crore.

The bye laws of the society provided for having 3 classes of members as follows:

Category of members	Eligibility criteria	Share capital	Rights
A class	Owners and partners to Trawl boat	500	All rights
B class	State Government	1000	
C class	People engaged in fishing and people transacting with the society	100	Excepting making deposits and obtaining loans, they do not have any other rights.

Thus, individual fishermen are admitted as C class members without voting rights and voting rights are restricted only to members admitted as A class members. As per proviso under section 80P(2)(a)(vii) of the Act, the deduction is allowable to the Co-operative Society provided the rules and bye-laws of the society restrict voting rights to Members only. As the condition under section 80P(2)(a)(vii) of the Act was not fulfilled the incorrect allowance of deduction of ₹ 0.96 crore had resulted in short levy of tax of ₹ 0.39 crore. ITD's reply is awaited (March 2020).

3.6 Deduction to Co-operative Societies under section 80P(2)(d) of the Act

The whole of interest and dividend income derived by a Co-operative Society from its investments in any other Co-operative Society is deductible under Section 80P(2)(d) of the Act. The provisions of this clause are very clear and the terms are clearly defined. However, the term 'whole of interest and dividend' has been subject matter of litigation. The judgments on the issue indicate that the deduction is for the entire income without adjusting the outgoings.

3.6.1 Audit examined 553 cases to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(d) of the Act.

- a. Audit found that in 553 cases in 14 states/regions⁷⁵ deduction of ₹ 455.63 crore was allowed based on claims made on income of ₹ 655.48 crore on account of interest from investment in Co-operative Banks under section 80P(2)(d) of the Act.
- b. Of 553 cases, in 126 cases the Assessing Officers had disallowed entire claim of deduction on interest income amounting to ₹ 150.31 crore derived from investments in Co-operative Banks. In 347 cases entire claim of ₹ 366.15 crore was allowed whereas in 79 cases partial allowance of ₹ 86.93 crore was made against claim of ₹ 136.47 crore. While disallowing the claims of deduction under section 80P(2)(d) of the Act the Assessing officers had placed reliance on decisions as per judicial rulings⁷⁶. The reasons for disallowance *inter alia* included 80P(2)(d) of the Act is not applicable to any Co-operative Bank other than PACS and Rural Development Bank, interest income earned from investment in surplus funds with other Co-operative Societies was not eligible for claim of deduction under section 80P(2)(d) of the Act, interest income from Co-operative Banks was not shown in profit and loss account and other assessment records, deduction claimed on interest received on NABARD bonds etc. Audit found that in eight cases⁷⁷ disallowance of claim of ₹ 1.97 crore was deleted and deduction claimed by assesseees were allowed by CIT(Appeals) or ITAT at different stages of appeal.

3.6.2 Differential Stand taken by Assessing Officers: Audit found that the Assessing Officers were taking differential stands with regard to treatment of interest income earned by Co-operative Societies from their investment in Co-operative Banks. In Karnataka, while in 49 cases, the Co-operative Societies had declared the interest earned as income from other sources, in 50 cases, the assesseees have treated them as business income, which were allowed by the Assessing Officers. In Maharashtra, Assessing Officers took differential stand in 6 cases (3 assesseees) while allowing deduction under section 80P(2)(d) of the Act resulting in tax effect of ₹ 0.72 crore. In case of two assesseees interest income earned from Co-operative Banks was allowed as deduction under section 80P(2)(d) of the Act in one AY although deduction was denied on the same in another AY wherein income earned from investment in Co-operative Banks was assessed under the head “Income from other sources”. Also, income earned from Co-operative Banks was allowed as deduction under section 80P(2)(d) of the Act in one AY whereas deduction

75 AP&TS, Bihar, Delhi, Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh, North Eastern Region (NER), Rajasthan, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

76 Pr. CIT, Hubballi vs Totagars Co-operative Sales Society [83 Taxmann.com 140 (Karnataka High Court, 2017), SBI Employees Co-operative credit and supply society limited v/s CIT Ahmedabad-1 [57 Taxman.com 367 (ITAT Ahmedabad, 2015)] and Gujarat State Co-operative Bank Limited [250 ITR 229 (Gujarat High Court, 2000)]

77 Gujarat, Maharashtra, Rajasthan and Uttar Pradesh

was denied in another AY by order under section 263 of the Act for receiving the deposits from non-members. One case is illustrated below:

Box 3.4

Illustration of differential stand taken by Assessing officers

a. Charge: Pr.CIT-20, Mumbai

AY: 2013-14

The scrutiny assessment of the assessee for AY 2013-14 was completed under section 143(3) of the Act in February 2016 after allowing deduction under section 80P(2)(d) of the Act on account of interest of ₹ 1.58 crore earned from investment in Co-operative Banks. The assessee Co-operative Society derived its income from providing credit facilities to its members and accepting deposits from non-members. Audit noticed that the assessee was denied the deduction under section 80P of the Act in AY 2014-15 by order under section 263 of the Act (March 2019) for receiving the deposits from non-members. The facts of the cases being the same, no deduction should have been allowed during AY 2013-14 also. The incorrect allowance had resulted in tax effect of ₹ 0.49 crore. ITD's reply is awaited (February 2020).

3.6.3 Audit further noticed 367 cases⁷⁸ in 12⁷⁹ States, out of cases examined, where Assessing Officers had incorrectly allowed deductions for interest income earned by Co-operative Societies. This had resulted in under assessment of income of ₹ 368.84 crore and short levy of tax of ₹ 145.64 crore.

Of 367 cases where audit noticed mistakes in allowance of deduction, 89.6 per cent of cases (viz. 329) were assessed under scrutiny viz. section 143(3) of the Act. Of 329 cases, in 232 cases the scrutiny was complete and in 46 cases it was limited whereas in the remaining 51 cases the type of scrutiny could not be ascertained. Of 46 cases examined under limited scrutiny, in 33 cases the criteria for selection of case for examination was on account of 'Large deduction claimed under Chapter VI-A'. It can be seen that audit noticed mistakes involving incorrect allowance of deduction under section 80P(2)(d) of the Act in such cases also that were selected for examination based on risk parameter of large deduction claimed under section 80P of the Act. These instances of incorrect assessments point towards inadequate examination of eligibility of incomes and admissibility of claims during assessment.

⁷⁸ These objections include audit objections based on generic checks applied to audit sample (as discussed in para 3.6.1) as well as specific checks applied to the sample as discussed in para 3.8 and 3.10 of this Chapter.

⁷⁹ Andhra Pradesh & Telangana, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North West Region, Odisha, Tamil Nadu, West Bengal

Three cases are illustrated below:

Box 3.5

Illustration of Incorrect allowance of deduction under section 80P(2)(d) of the Act

**a) Charge: Pr. CIT-1, Bhopal
Assessment Year: 2016-17**

The scrutiny assessment of the assessee was completed in December 2018 under section 143(3) of the Act, determining Nil income. The assessee filed its return of income for A.Y. 2016-17 at 'Nil' income on 31.03.2018 claiming deduction of ₹ 9.82 crore under section 80P of the Act. Audit examination revealed that the Assessing Officer allowed the deduction of ₹ 9.82 crore, which included deduction under section 80P(2)(d) of the Act on account of interest received from the Co-operative Bank/Scheduled Bank. As the interest received from the Co-operative Bank/Scheduled Bank amounting to ₹ 9.82 crore is not an allowable deduction under section 80P(2)(d) of the Act, it was required to be disallowed. The mistake had resulted in underassessment of income of ₹ 9.82 crore with a consequent short levy of tax of ₹ 5.06 crore.

ITD stated in its reply that the interest received from Co-operative Society is exempt under section 80P(2)(d) of the Act and that Co-operative Banks are Co-operative Societies registered with ROC. The reply is not acceptable as the Co-operative Societies work for members only and cater to the member's requirements. However, the Co-operative Banks are engaged in commercial banking activity that includes taking deposits and giving loans to non-members also. This fact is also not discussed in records. Further, ITD had also withdrawn the benefits of section 80P of the Act from the Co-operative Banks. Therefore, the interest earned by the assessee from investment or deposits in Co-operative Banks or other banks is not allowable as a deduction under section 80P(2)(d) of the Act.

**b) Charge: Pr.CIT 2, Jaipur
Assessment Year: 2015-16**

The scrutiny assessment of an AOP for AY 2015-16 was completed in December 2017 at 'Nil' returned income after allowing deduction of ₹ 4.15 crore under section 80P(2)(d) of the Act to the extent of available profit of ₹ 3.06 crore. Audit examination revealed that the amount of interest of ₹ 3.69 crore was earned on FDR with Co-operative Bank, which

did not fall in the scope of the provision of section 80P(2)(d) of the Act and was not allowable. However, ₹ 0.45 crore was allowable to the assessee as per the provision. The incorrect allowance of deduction of ₹ 3.69 crore resulted in under computation of income ₹ 2.61 crore (₹ 3.06 crore - ₹ 0.45 crore) involving tax effect of ₹ 1.03 crore, the interest of ₹ 0.11 crore to be withdrawn under section 244 of the Act and ₹ 0.03 crore chargeable under section 234D of the Act. Reply of ITD is awaited (March 2020).

3.7 Deduction to Co-operative Societies under section 80P(2)(e) of the Act

As per section 80P(2)(e) of the Act deduction in respect of any income derived by the Co-operative Society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is allowable. It has judicially been held⁸⁰ that the whole of the income derived by a Co-operative Society from the letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities is deductible under section 80P(2)(e) of the Act.

3.7.1 Audit examined 38 cases in 11 states⁸¹ to ascertain the eligibility of Co-operative Societies claiming deduction under section 80P(2)(e) of the Act. Of 38 cases, in 32 cases⁸² the assessee had made claim of deduction under section 80P(2)(e) of the Act on income derived from letting of godowns or warehouses for purpose other than storage, processing or facilitating the marketing of commodities; in 5 cases⁸³ the claim was made on income derived from letting out of storage for marketing purpose only and in one case⁸⁴ deduction claimed on income was derived from stocking of goods in godown.

It was seen that out of 38 cases, in 15 cases entire claim of ₹ 10.34 crore was allowed, in 18 cases entire claim of ₹ 35.13 crore was disallowed whereas in five cases partial claim was allowed at ₹ 35.75 crore against total claim of ₹ 45.39 crore during assessment of claim of deduction under section 80P(2)(e) of the Act.

3.7.2 Audit noticed five cases in Gujarat, out of 38 cases examined, where Assessing Officers had allowed deductions for rent income earned from a source other than letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities. This had resulted in under

80 *CIT v. District Co-operative Federation [2004] 271 ITR 22 (All.)*

81 AP&TS, Gujarat, Karnataka, Madhya Pradesh, Maharashtra, NER, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

82 AP&TS, Gujarat, Karnataka, Maharashtra, NER, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

83 AP&TS, Gujarat, Karnataka, Madhya Pradesh.

84 Madhya Pradesh

assessment of income of ₹ 0.30 crore and short levy of tax of ₹ 0.12 crore. One of these cases is illustrated below:

Box 3.6

Illustration of Incorrect allowance of deduction under section 80P(2)(e) of the Act

a) Charge: PCIT- 3, Ahmedabad

AY: 2013-14 and 2014-15

The assessee filed return of income at nil for AY 2013-14 and AY 2014-15 in October 2013 and October 2014 respectively. The scrutiny assessment of the assessee for AY 2013-14 and AY 2014-15 was completed under section 143(3) of the Act in November 2015 and December 2016 respectively by accepting returned income. Audit examination revealed that the assessee had claimed deduction of ₹ 16.87 crore during AY 2013-14 and ₹ 13.03 crore during AY 2014-15 which included rent income of ₹ 0.14 crore (AY 2013-14) and ₹ 0.15 crore (AY 2014-15). As rent was not an allowable deduction the same was required to be disallowed. This mistake had resulted in underassessment of income by ₹ 0.14 crore and ₹ 0.15 crore involving short levy of tax of ₹ 0.06 crore and ₹ 0.06 crore during AY 2013-14 and AY 2014-15 respectively. ITD's reply is awaited (June 2020).

3.8 Disallowances in case of assessments of Co-operative Societies

Audit attempted to verify reasons for disallowance in 222 cases⁸⁵ where additions made by Assessing Officers were equal to deduction claimed under section 80P of the Act amounting to ₹ 259.06 crore. Audit noticed that entire claim of deduction of ₹ 0.50 lakh was allowed under section 80P of the Act in one case⁸⁶. In 221 cases of 13 states⁸⁷ the claim of deduction under section 80P of the Act was either disallowed fully or partly. In 210 (94.6 per cent) cases⁸⁸ the entire claim amounting to ₹ 125.79 crore was disallowed whereas in 11 (5 per cent) cases⁸⁹ claim amounting to ₹ 130.66 crore was disallowed partially.

Audit found that of 221 cases where AOs had made disallowance (fully or partially), in 111 cases⁹⁰ the assessee were held as ineligible for claim of deduction admissible to Co-operative Societies as they were engaged in

85 AP&TS, Gujarat, Karnataka, Kerala, Odisha, Madhya Pradesh, Maharashtra, NER, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh and West Bengal.

86 Madhya Pradesh.

87 AP&TS, Odisha, MP, Tamil Nadu, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, NER, UP, and West Bengal

88 AP&TS, Odisha, MP, Tamil Nadu, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, NER, UP, and West Bengal

89 Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh and Odisha

90 Gujarat, Karnataka, Kerala, Maharashtra, Madhya Pradesh, NER, Rajasthan and Tamil Nadu.

banking activity; in seven cases⁹¹ the assessees were treated as non-PACS whereas in 24 cases⁹² the claim had been made on ineligible income viz. income from business activity or interest income earned from investment in banks other than those in Co-operative Sector. Thus, the disallowance of deduction claimed under section 80P of the Act was on account of assessee either not being engaged in activities listed out in the Act for Co-operative Societies or being engaged in specified activity to a limited extent compared to principal activity or business. This entailed major risk of entities not fulfilling conditions specified in the Act and claiming benefits wrongfully indicating thereby potential abuse of tax provision introduced with the legislative intention of facilitating the growth of Co-operative Sector.

Audit further found that out of 221 cases, where the disallowance had been made, inter alia, on the pretext that assessee was engaged in banking business or deduction had been claimed on ineligible income viz. interest earned from nationalised banks or assessee not working as PACS, in 47 cases assessees resorted to legal action. Of 47 cases, 32 cases⁹³ were allowed in favour of assessee by CIT(Appeals), one case⁹⁴ was allowed partly in favour of assessee and 14 cases⁹⁵ were pending in litigation before CIT(Appeals). Thus, the disallowances made by the ITD could not be sustained in courts of law.

Audit noticed 05 cases⁹⁶ of irregular allowance of deduction under section 80P of the Act involving tax effect of ₹ 1.14 crore. These mistakes are included in the instances of non-compliance discussed in para 3.2 to 3.7 of this chapter.

3.9 Non-uniformity in making assessments of assessees in Co-operative Sector engaged in banking activities

As per Banking Regulation Act, 1949, Co-operative Bank means State Co-operative Banks (SCBs), Central Co-operative Banks (CCBs) and Primary Co-operative Banks (PCBs). As per section 80P(4) of the Act, the provisions of section 80P of the Act shall not apply in relation to any Co-operative Bank other than a PACS or a Primary Co-operative Agricultural and Rural Development Bank.

Audit examined 336 assessment cases of Co-operative Sector where assessees were engaged in rural banking, agricultural and rural development banking and land development banking. Audit noticed that the Assessing Officers were adopting differential approach in allowance of deduction

91 Kerala.

92 Gujarat, Karnataka, Kerala, Maharashtra, Tamil Nadu and West Bengal.

93 Karnataka, Kerala, Maharashtra.

94 Gujarat.

95 Kerala.

96 Karnataka & Goa and Kerala.

claimed under section 80P of the Act while completing assessments of assesseees categorised as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks as brought out in the table depicted below. Audit analysed the extent of allowance or disallowance amongst assesseees engaged in banking activities as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks. Audit noticed that the deduction claimed under section 80P of the Act was allowed in 106 cases⁹⁷, entire claim of deduction under section 80P of the Act was disallowed in 50 cases⁹⁸ and in 180 cases⁹⁹ nil claims had been made by the assessee under section 80P of the Act. The reasons for disallowance were assessee being engaged in banking activities and held as ineligible for claim of deduction under section 80P(4) of the Act. The extent of allowance of deduction to similar class of assesseees engaged in agricultural, rural and development banking in Co-operative Sector under section 80P of the Act is shown in table 3.4 below.

Table 3.4: Allowance of deduction under section 80P of the Act to assesseees engaged in banking activities.

Nomenclature of Bank	Assessment cases where deduction under section 80P of the Act was claimed and allowed					Assessment cases where entire claim of deduction under section 80P of the Act was disallowed			
	Co-operative Societies (No.)	Co-operative Banks (No.)	Total (No.)	Amount of 80P deduction claimed (₹ in crore)	Amount of 80P deduction allowed by ITD (₹ in crore)	Co-operative Societies (No.)	Co-operative Banks (No.)	Total (No.)	Amount of 80P deduction claimed (₹ in crore)
Gramin Bank/ Rural Bank/ Grameen Vikas Bank	21	7	28	354.6	353.7	20	8	28	1916.7
Bhoomi Vikas Bank/ Land Development Bank	20	20	40	33.0	35.9	4	8	12	5.4
Primary Agricultural & Rural Development Bank/ Co-operative Agricultural Bank/ State Agricultural & Rural Development Bank	33	5	38	914.7	361.9	8	2	10	113.1
Total	74	32	106	1302.3	751.5	32	18	50	2035.3

97 AP&TS, Gujarat, Karnataka, Kerala, Maharashtra, NWR, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

98 AP&TS, Bihar & Jharkhand, Karnataka, Kerala, Rajasthan, Tamil Nadu, Uttar Pradesh & Uttarakhand, West Bengal & Sikkim.

99 AP&TS, Bihar & Jharkhand, Gujarat, Karnataka, Kerala, NER, Rajasthan, West Bengal & Sikkim.

As such, the Assessing Officers did not apply the provisions of the Act uniformly while determining allowance of deduction under section 80P of the Act in cases pertaining to similar class of assessees in Co-operative Sector. The reasons for wide variations in the applicability of same law under similar conditions need to be examined to ensure consistency and uniformity in assessment of similar class of assessees engaged in similar activities in Co-operative Sector. It is further required to co-ordinate with regulatory bodies to align the assessment of such assessees in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies.

3.10 Assessment of Co-operative Societies with high value claims of deduction under section 80P of the Act

Audit examined 257 cases involving highest claim of deduction under section 80P of the Act to examine the nature and extent of compliance to specific provision for Co-operative Societies in the Income Tax Act.

- a) Of 257 top cases where deduction of ₹ 7,000.73 crore was claimed under section 80P of the Act, in 82 *per cent* cases deduction was claimed under section 80P(2)(a)(i) of the Act applicable to Co-operative Societies engaged in the business of banking or providing credit facilities to its members (51.36 *per cent*) or under section 80P(2)(d) of the Act i.e. income by way of interest or dividends derived by Co-operative Society from its investments with any other Co-operative Society (30.74 *per cent*).
- b) Out of 257 cases, 115 cases were selected under Computer Assisted Scrutiny Selection¹⁰⁰ (CASS) for large deduction claimed under section 80P / Chapter VIA of the Act. Of 115 cases selected for large deduction claimed under section 80P of the Act / Chapter VIA, 100 cases were selected for complete scrutiny and 15 were selected for limited scrutiny.
- c) Of 115 cases examined by AOs under complete or limited scrutiny, entire claim of deduction was allowed in 32 cases whereas partial claim was allowed in 57 cases. Audit found that in 17 cases entire amount of deduction claimed under section 80P of the Act was disallowed for reasons such as assessee being engaged in banking business or deduction claimed on ineligible income viz. income from other sources. Such high proportion of disallowance in the top cases claiming deduction indicates the tendency for abuse of the deduction provision, especially by those Co-operative Societies engaged in

100 ITD has implemented the Computer Assisted Scrutiny Selection (CASS) system to select income tax returns for scrutiny on a compulsory selection basis using predefined criteria on a centralised basis.

banking business or providing credit facilities to its members or under section 80(2)(d) of the Act.

3.10.1 Audit noticed 38 cases¹⁰¹ of irregular allowance of deduction under section 80P of the Act involving tax effect of ₹ 52.83 crore. These mistakes are also included in the instances of non-compliance to different sub-sections of section 80P of the Act as discussed in para 3.2 to 3.7 of this chapter. Two cases are illustrated below:

Box 3.7

Illustration for irregular allowance of deduction under section 80P of the Act in high value claims

a) Charge : PCIT-1, Bengaluru

Assessment year : 2012-13, 2013-14 & 2014-15

The assessee, an AOP, is an apex Co-operative institution of the state for (1) the distribution of chemical fertilisers, pesticides and seeds, (2) procurement and marketing of agricultural commodities, (3) nodal agency for agricultural commodities procurement under MSP of the Government, and (4) distributes certain consumer products. Scrutiny assessment of the federal Co-operative Society for the AY 2012-13, 2013-14 and 2014-15 were concluded during March 2015, March 2016 and December 2016 respectively disallowing the deduction claimed on interest earned from nationalised bank treating it as “Income from other sources”. Audit observed that the assessee, apart from nationalised bank, has deposited its surplus fund in Apex bank also which is the “central bank” controlling all other Co-operative Banks in Karnataka and is governed by the Banking Regulation Act, 1949. Consequent to insertion of section 80P(4) of the Act, interest earned on surplus fund deposited in Apex bank is taxable. However, assessing officer has allowed deduction amounting to ₹ 0.55 crore, ₹ 4.33 crore and ₹ 3.92 crore for the AY 2012-13, 2013-14 & 2014-15 respectively. As a result, there is loss of revenue of ₹ 0.23 crore, ₹ 1.82 crore and ₹ 1.77 crore for the AY 2012-13, 2013-14 and 2014-15 respectively. ITD stated in its reply (May 2020) that in respect of AY 2012-13 no action is possible as the case is time barred while in respect of other AYs, appropriate remedial action would be taken and intimated to audit in due course.

101 AP&TS, Gujarat, Madhya Pradesh, Karnataka & Goa, Gujarat, Maharashtra, North Western Region, Uttar Pradesh and West Bengal

b) Charge : PCIT-Mangalore

Assessment year : 2012-13, 2013-14, 2014-15 & 2016-17

The assessee, a Co-operative Society registered as an AOP, is engaged in activities of marketing agricultural produce i.e. arecanut, raw rubber grown by its members and produces chocolate from cocoa beans. Scrutiny assessment of the Co-operative Society for the AY 2012-13, 2013-14, 2014-15 and 2016-17 were concluded during September 2014, January 2016, December 2016 and November 2018 respectively. The assessee earned interest income from investments in Co-operative Banks to the extent of ₹ 0.19 crore, ₹ 0.20 crore, ₹ 0.21 crore and ₹ 0.22 crore and claimed the same as deduction under section 80P(2)(d) of the Act. Assessing officer too admitted the deduction leading to loss of revenue of ₹ 0.07 crore, ₹ 0.08 crore, ₹ 0.10 crore and ₹ 0.10 crore for the AY 2012-13, 2013-14, 2014-15 and 2016-17, respectively. ITD while not accepting the audit objection replied (May 2020) and cited the jurisdictional Karnataka High Court decision in the case of Principal Commissioner of Income Tax, Hubli vs Totagar's Co-operative Sale Society, 2017 [392 ITR 74] which has ruled that "for purpose of section 80P(2)(d) of the Act a Co-operative Bank should be considered as a Co-operative Society" and thus the assessee is eligible to claim the deduction under section 80P(2)(d) of the Act for interest earned from Co-operative Banks.

The reply of ITD is not tenable, as the Assessing Officer has quoted jurisdictional High Court order [dated 05.01.2017] in the case of "The Totagar's Co-operative Sale Society Ltd." for AY 2012-13 only. The jurisdictional High Court of Karnataka, Dharwad Bench while deciding the case of the same assessee [Totagar's Co-operative Sale Society] for the AYs 2007-08 to 2011-12 pronounced on 16 June 2017 after considering its own order dated 5 January 2017 [vide para 18 and 19 of the Honorable High Court order], has ruled that the assessee is not eligible to claim deduction under section 80P(2)(d) of the Act for interest earned from Co-operative banks. The allowability needs to be re-examined in view of subsequent judicial ruling made in June 2017.

Audit, further, noticed that there is no mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The ITR does not capture the sub-section of section 80P of the Act under which the assessee claims deduction under section 80P of the Act. Thus, it is not clear as to how the ITD is allowing deduction without verifying the eligibility of the assessee or the fulfilment of conditions laid out under the provisions of the Act for specified activities. While Income Tax Act has specified the nature

of activities in respect of which Co-operative Societies can claim deduction under section 80P of the Act, it does not have any mechanism to monitor the same in order to assess the fulfilment of legislative intention behind introduction of benefit of deduction to Co-operative Societies under the Act. ITD should devise a mechanism to effectively monitor the nature of activities undertaken by a Co-operative Society while also verifying the incomes on which deduction is being claimed by the Co-operative Societies to ensure allowance of claim to eligible assessee only.

3.11 Incorrect allowance of deduction of Provision for bad and doubtful debts

Section 36(1)(viii) of the Act stipulates that provision for bad and doubtful debts allowed to a Scheduled Bank or a Co-operative Bank other than a PACS or a primary co-operative agricultural and rural development bank, shall not exceed seven and one-half per cent of the total income (computed before making any deduction under this clause and Chapter VIA of the Act) and an amount not exceeding ten per cent of the aggregate average advances made by the rural branches of such bank computed in the prescribed manner. Further, as per 36(2)(v) of the Act, no such deduction shall be allowed unless the assessee has debited the amount of such debt or part of debt in that previous year to the provision for bad and doubtful debts account made under that clause.

Audit examined 487 cases¹⁰² involving claim of deduction of ₹ 4,085.16 crore to ascertain the eligibility of Co-operative Banks claiming deduction on account of provision of bad and doubtful debts under section 36(1)(viii) of the Act.

- a) Audit found that of 487 cases, entire claim of deduction was allowed in 324 cases (66.5 per cent).

The details of the 324 cases where entire claims were allowed during assessment are presented in the table below.

¹⁰² Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal

Table 3.5: Deduction claimed under section 36(1)(viiia) of the Act on account of Provision for Bad and Doubtful Debts

(₹ in crore)

Claims made under section 36(1)(viiia) of the Act		Deduction claimed on gross total income only (fully allowed by ITD)		Deduction claimed on aggregate advances only (fully allowed by ITD)		Deduction claimed on gross total income and aggregate advances where bifurcation not available (fully allowed by ITD)		Deduction claimed on gross total income and aggregate advances (fully allowed by ITD)	
No.	Amount of Deduction claimed	No.	Amount of Deduction claimed	No.	Amount of Deduction claimed	No.	Amount of Deduction claimed	No.	Amount of Deduction claimed
487	4,085.16	142	815.64	94	772.13	54	430.67	34	740.21

The ITR in the existing format does not capture the distinct figures/ details of deduction claimed under section 36(1)(viiia) of the Act on total income and on rural advances. Audit could not ascertain the same from the available records as brought out above. It was not clear as to how the Assessing Officers were verifying the claim of deduction on account of provision for bad and doubtful debts while allowing the same during assessment. It is, therefore, suggested that the claim amount on total income and rural advances may be captured distinctly for effective monitoring and assessment of impact of deduction allowed to the Co-operative Banks.

3.11.1 Audit noticed 118 cases¹⁰³ in 18¹⁰⁴ states where the Assessing Officers had irregularly allowed deduction under section 36(1)(viiia) of the Act on account of provision for bad and doubtful debts without ensuring fulfilment of the conditions laid down in the Income Tax Act. This had resulted in under assessment of income of ₹ 1,002.78 crore and short levy of tax of ₹ 375.20 crore.

Audit found that out of 118 cases, 71 cases (viz. 60.1 per cent) were examined under complete scrutiny whereas 18 cases were examined under limited scrutiny. In 71 cases involving claim of deduction of ₹ 909.79 crore and allowance of deduction of ₹ 712.58 crore under section 36(1)(viiia) of the Act, though the type of scrutiny examination was complete, audit noticed mistakes involving incorrect allowance of deduction under section 36(1)(viiia)

¹⁰³ The audit objections include irregularities noticed in audit with respect to cases subjected to generic checks and (as discussed in para 3.11) and those subjected to specific checks (as discussed in para 3.11.3 of this chapter).

¹⁰⁴ Andhra Pradesh & Telangana, Bihar, Chhattisgarh, Delhi, Gujarat, Jharkhand, Karnataka and Goa, Kerala, Madhya Pradesh, Maharashtra, North East Region, North West Region, Odisha, Tamil Nadu, Uttar Pradesh, Uttarakhand and West Bengal.

of the Act. These instances of incorrect assessments point towards inadequate examination of admissibility of claims during assessment.

Three cases are illustrated below:

Box 3.8

Illustration of Irregular allowance of deduction for provision under section 36(1)(viiia) of the Act

**(a) Charge: PCIT-Shillong
AY: 2014-15**

The scrutiny assessment of the assessee for AY 2014-15 was completed under section 143(3) of the Act in December 2016 determining income of ₹ 4.83 crore. The assessee preferred an appeal and on the basis of appeal order an effect was given in November 2017 determining income of ₹ 3.79 crore. Audit examination revealed that the assessee had made a provision of ₹ 6.00 crore, under section 36(1)(viiia) of the Act, in the accounts but had claimed deductions of ₹ 87.29 crore which was restricted to ₹ 84.78 crore in the assessment under section 143(3) of the Act. This resulted in excess allowance of deduction of provision of ₹ 78.78 crore and short levy of tax of ₹ 26.78 crore. ITD's reply is awaited (June 2020).

**b) Charge: PCIT-1 Patna,
AY: 2013-14**

The scrutiny assessment of the assessee was completed in February 2016 at an income of ₹ 16.35 crore. Audit noticed that an amount of ₹ 33.91 crore was debited in profit & loss account towards provision and contingencies and net profit was shown at ₹ 65.31 crore. During computation of income, after adjustment made as required, total income was calculated at ₹ 104.34 crore before deduction under Chapter VI and after claiming deduction of ₹ 213.51 crore under section 36(1) (viiia) of the Act including ₹ 205.69 crore as deduction for rural advance, returned income was filed at a loss of ₹ 109.18 crore. During scrutiny assessment returned income of assessee was taken at nil and after addition under two heads, income was assessed at ₹ 16.35 crore. As the assessee had debited total provision of ₹ 33.91 crore hence claimed deduction of ₹ 213.51 crore was required to be restricted up to the amount debited in profit and loss account i.e. ₹ 33.90 crore. However, deduction of ₹ 104.34 crore was allowed. The mistake resulted in excess allowance of deduction of ₹ 70.43 crore involving tax effect of ₹ 21.76 crore. The reply of ITD is awaited (June 2020).

**c) Charge: CIT Jamshedpur,
Assessment Year: 2011-12, 2012-13, 2013-14, 2014-15**

The assessment of the assessee was completed under section 143(3)/147/263 of the Act for the AYs 2011-12 to 2014-15 December 2016, December 2018, March 2016 and December 2016 and assessed at ₹ 3.04 crore, ₹ 5.50 crore, ₹ 3.61 crore and ₹ 2.65 crore respectively. Audit examination revealed that the assessee had made provisions of ₹ 16.23 crore in excess that was allowable under section 36(i)(viia) of the Act. The omission had resulted in irregular allowance of provisions of ₹ 16.23 crore¹⁰⁵ with consequent short levy of tax of ₹ 8.02 crore¹⁰⁶ Including interest. ITD stated (July 2019) in its reply that the issue raised by the audit will be examined and action as per law will be taken. Further details of remedial action taken by ITD are awaited (June 2020).

3.11.2 Monitoring of claims made on account of Provision for Bad and Doubtful Debts through Income Tax Return

The existing format of ITR-5 does not capture the claim made by assessee under section 36(1)(viia) of the Act. Further, the data furnished by the DGIT(Systems) shows amount of provision for bad and doubtful debts as per books of accounts and not the actual amount of claim of deduction under section 36(1)(viia) of the Act. Part A- Other Information of ITR-5 form captures the details of deduction under section 36(1)(viia) of the Act (viz. under amounts debited to the profit and loss account, to the extent disallowable). Audit noticed that in such cases where assessee added back the amount of "Provision for Bad and Doubtful Debts" in its computation of income, the amount claimed and allowed on account of provision for bad and doubtful debts was nil. However, the effective claim of deduction was not getting reflected in ITR. ITD may make a provision to capture the deduction claimed under section 36(1)(viia) of the Act by the assessee in the ITR form.

3.11.3 High value claims of deduction under section 36(1)(viia) of the Act

Audit examined 117 cases¹⁰⁷ of high value claims or deduction amounting to ₹ 1,707.78 crore under section 36(1)(viia) of the Act on account of provision for bad and doubtful debts to ascertain whether the deduction claimed under section 36(1)(viia) of the Act on account of provision for bad and doubtful

105 ₹ 16.23 crore = ₹ 7.69 crore (AY 2011-12) + ₹ 1.85 crore (AY 2012-13) + ₹ 1.51 crore (AY 2013-14) + ₹ 5.18 crore (AY 2014-15).

106 ₹ 8.02 crore = ₹ 4.01 crore (AY 2011-12) + ₹ 1.03 crore (AY 2012-13) + ₹ 0.64 crore (AY 2013-14) + ₹ 2.34 crore (AY 2014-15).

107 AP&TS, Gujarat, Karnataka, Kerala, Madhya Pradesh, Maharashtra, NER, Rajasthan, Tamil Nadu and West Bengal.

debts had been examined and allowed correctly. Audit found that the Assessing Officers had allowed entire claim of deduction of ₹ 1,144.06 crore in 88 cases while allowing partial claim of deduction of ₹ 125.30 crore against total claim of ₹ 563.72 crore in 29 cases.

Audit noticed 12 cases¹⁰⁸ of irregular allowance of deduction under section 36(1)(viia) of the Act involving tax effect of ₹ 39.36 crore. These mistakes are included in the instances of non-compliance discussed in para 3.10.1 of this chapter. The incorrect allowance was on account of non-restriction of claim to the provision made thereof, mistake in computation of claim due to non-consideration of revised total income etc. One case is illustrated below:

Box 3.9

Illustration of high value claims of deduction under section 36(1)(viia) of the Act

Charge: Pr.CIT-2, Nagpur

Assessment Year: 2013-14

The assessee had claimed and was allowed deduction of ₹ 15.71 crore on account of 'provision for bad and doubtful debts' under section 36(1)(viia) of the Act. Audit noticed that the assessee had made provision for bad and doubtful debts amounting to ₹ 7.04 crore only. Hence, the allowance should have been restricted to that extent. This had resulted in incorrect allowance of deduction by ₹ 8.67 crore involving tax effect of ₹ 2.68 crore. ITD's reply is awaited (June 2020).

There was a risk of non-compliance in high value claims of deduction under section 36(1)(viia) of the Act. As already suggested in para 3.9 of this chapter ITD may consider capturing distinct figures of claim of deduction under section 36(1)(viia) of the Act on total income and on rural advances in ITR for monitoring of extent of claim and compliance thereupon.

3.12 Incorrect allowance of deduction for special reserve under section 36(1)(viii) of the Act

Section 36(1)(viii) of the Act stipulates that in computing income from business, a deduction of 20 per cent of income from eligible business during the year shall be allowed in respect of any special reserve created and maintained by a specified entity. The Explanations below the section further explain the terms –'specified entity' and 'eligible business' which encompasses "development of housing in India" to mean cluster development of housing infrastructure by providing long term finance to the builders and developers. Deduction for providing long term finance for "construction or purchase of houses in India for residential purposes" is exclusively available to the 'Housing Finance Company'. Harmonious reading of

108 Madhya Pradesh, Karnataka & Goa, Kerala, Maharashtra, North East Region and Tamil Nadu

provisions of section 36(1)(viii) of the Act and Explanations thereunder thus makes it abundantly clear that individual housing loan does not qualify for deduction under section 36(1)(viii) of the Act in the case of Banks/Co-operative Banks and Financial Institutions other than a 'Housing Finance Company'. It has been judicially held (March 2019) in the case of South Indian Bank Ltd. Vs. ACIT, ITAT, Cochin Bench that special reserve deduction under section 36(1)(viii) of the Act was not allowable to assessee bank with respect to income from Individual housing loans stating that purchase/construction of individual houses does not amount to Housing Development.

Audit examined 114 cases to ascertain the eligibility of Co-operative Banks claiming deduction under section 36(1)(viii) of the Act.

- a) Audit noticed that of 114 cases in 10 states/ regions¹⁰⁹ where assessees had claimed deduction amounting to ₹ 354.84 crore under section 36(1)(viii) of the Act, of which, the Assessing Officers had made disallowance of ₹ 117.81 crore while allowing claim of ₹ 237.03 crore.
- b) Of 114 cases, in 82 cases the entire claim of deduction of ₹ 212 crore was allowed under section 36(1)(viii) of the Act. Of 82 cases, in 12 cases where deduction of ₹ 5.21 crore was allowed under section 36(1)(viii) of the Act the period for which loans or advances were provided was not ascertainable from the available records. As such, the fulfilment of basic condition of assessee being engaged in providing long term finance could not be ascertained in audit.
- c) Of 114 cases, in 16 cases the AOs had disallowed entire claim of deduction of ₹ 85.98 crore for reasons such as non-creation of any special reserve by assessee or the business of the assessee was not related to only long term finance.
- d) In remaining 16 cases of 114 cases, the claim of ₹ 25.03 crore was partially allowed against total claim of ₹ 56.87 crore.

3.12.1 Of cases examined with respect to claims under section 36(1)(viii) of the Act, audit noticed irregularities in 8 cases in Bihar and Maharashtra where ITD had allowed deductions for provision for special reserve incorrectly violating the conditions laid down in the Income Tax Act. This had resulted in under assessment of income of ₹33.20 crore and short levy of tax of ₹ 14.01 crore. Audit found that out of 8 cases, 3 cases involving tax effect of ₹ 10.43 crore were examined under complete scrutiny.

109 AP&TS, Bihar, Gujarat, Karnataka, Kerala, Maharashtra, North Western Region (NWR), Odisha, Tamil Nadu, Rajasthan, North Eastern Region (NER) and West Bengal.

Two cases are illustrated below:

Box 3.10

Illustration of Incorrect allowance of deduction under section 36(1)(viii) of the Act

a) Charge: PCIT-1 Patna

AY: 2014-15

The scrutiny assessment of the assessee was completed in December 2016 at an income of ₹ 83.03 crore. Audit noticed that the assessee had claimed and was allowed deduction of ₹ 20.75 crore under section 36(1)(viii) of the Act on total income comprising income from interest, income from investment and other income. Audit also noticed that no special reserve was created in books of account in this regard. As the assessee had not created any special reserve for deduction under section 36(1)(viii) of the Act and deduction claimed from all income in place of only from eligible business income, the same was required to be disallowed and added back to total income. The mistake resulted in incorrect allowance of deduction under section 36(1)(viii) of the Act amounting to ₹ 20.75 crore involving tax effect of ₹ 9.78 crore (including interest). ITD's reply is awaited (June 2020).

b) Charge: PCIT-1 Mumbai

AY: 2016-17

In Maharashtra, in the scrutiny assessment for A.Y. 2016-17 of an assessee functioning as a Co-operative Bank, deduction of ₹ 17 crore was allowed as claimed under section 36(1)(viii) of the Act. Audit noticed that as per the details of long term finance loan the amount of ₹ 309.69 crore related to Vastu siddhi, Property loan scheme, Commercial real estate etc. As these loans do not fall under 'eligible business' for qualifying deduction, the allowance of deduction for long term finance on the above amount was incorrect. This had resulted in excess allowance of deduction of ₹ 9.36 crore involving short levy of tax of ₹ 3.18 crore. ITD's reply is awaited (June 2020).

3.13 Irregular allowance of expense to Co-operative Societies under section 36(1)(xvii) of the Act for purchase of sugarcane.

The Central Government fixes the Fair and Remunerative Price (FRP) of sugarcane based on the recommendations of Committee for Agricultural Costs and Prices (CACCP) and after consultations with State Governments and other stakeholders. FRP determined under Sugarcane (Control) Order 1966 is the minimum price that sugar mills have to pay to sugarcane farmers. Besides, the Central Government and State Governments also notify various incentives and schemes for promotion of sugar manufacturing entities/ sugar industry from time to time.

The Central Government by notification fixes the price of sugarcane to be paid by producers of sugar for the sugarcane purchased by them. As per New Price Mechanism, from 22nd October 2009 Fair and Remunerative Price (FRP) came into existence. In consonance with the above, a new clause [section 36(1)(xvii)] has been inserted by Finance Act, 2015, with effect from 1 April 2016. Section 36(1)(xvii) of the Act provides that, deduction provided for the amount of expenditure incurred by a Co-operative Society engaged in the business of manufacture of sugar for purchase of sugarcane at a price which is equal to or less than the price fixed or approved by the Government, shall be allowed in computing the income referred to in section 28 of the Act.

Audit examined 111 cases involving claim of deduction of ₹ 24,664.78 crore under section 36(1)(xvii) of the Act in Gujarat and Maharashtra to ascertain the eligibility of Co-operative Societies claiming deduction under section 36(1)(xvii) of the Act. Audit found that in 111 cases the Assessing Officers had made disallowance of ₹ 6,668.43 crore (27 per cent) due to non-fulfilment of conditions specified under provisions of the Act while allowing deduction of ₹ 17,996.35 crore. The AOs had allowed full claim of deduction under section 36(1)(xvii) of the Act amounting to ₹ 887.05 crore in four cases out of 111 cases whereas in 107 cases partial allowance of deduction of ₹ 17,109.30 crore was made against claim of deduction ₹ 23,777.73 crore under section 36(1)(xvii) of the Act. The Assessing Officers had disallowed the excess sugar purchase price claimed as expenditure by the assessee which was more than Minimum Support Price (MSP) rate fixed by the Government.

Table 3.6: Deduction claimed under section 36(1)(xvii) of the Act on account of expenditure for purchase of sugarcane

(₹ in crore)

Claims made under section 36(1)(xvii)		Entire claim under section 36(1)(xvii) allowed by ITD		Claim under section 36(1)(xvii) partially allowed by ITD		
No. of cases	Amount of deduction claimed	No. of cases	Amount of deduction claimed	No. of cases	Amount of deduction claimed	Amount of deduction allowed
111	24664.78	4	887.05	107	23777.73	17109.30

The state-wise amount of deduction claimed and allowed is given below.

Table 3.7: State-wise amount of deduction claimed under section 36(1)(xvii) of the Act

(₹ in crore)

State	No of cases	Deduction claimed under section 36(1)(xvii)	Deduction allowed under section 36(1)(xvii) by ITD
Gujarat	38	8291.00	5392.35
Maharashtra	73	16373.78	12604.00
Grand Total	111	24664.78	17996.35

The quantum of claim of deduction made by sugar Co-operatives is significantly high [average of around ₹ 220 crore of deduction under section 36(1)(xvii) is being claimed by a sugar manufacturing entity]. The possibility of inflated claims being made by sugar manufacturing Co-operatives is also high (27 per cent of disallowance was made by AOs in 111 cases).

The returned income in respect of the 111 cases was ₹ 135.75 crore, while the assessed income was ₹ 6888.88 crore, indicating addition of ₹ 6753.13 crore. The AOs raised a demand, accordingly, of ₹ 2903.16 crore.

Of 111 cases, audit noticed irregularities in 19 cases of Maharashtra [returned loss ₹ 30.74 crore and assessed income of ₹ 1100.36 crore for the 19 cases], registered as AOP with ITD, where ITD had incorrectly allowed deductions on account of harvesting and transportation expenses under section 36(1)(xvii) of the Act. This had resulted in under assessment of income of ₹ 318.53 crore and short levy of tax of ₹ 107.75 crore. One case is illustrated below.

Box 3.11

Illustration for Irregular allowance of expense to Co-operative Societies under section 36(1)(xvii) of the Act

CIT Charge: Pr.CIT 3 Pune

AYs: 2012-13, 2013-14, 2014-15 and 2015-16

Audit examination revealed that while completing assessments of an AOP for AYs 2012-13, 2013-14, 2014-15 and 2015-16, the Harvesting and Transportation (H&T) expenses were not adjusted while computing the disallowance of excess sugarcane price. The view taken by ITD was not consistent with the case of another assessee. This had resulted in irregular allowance of expenditure of ₹ 180.21 crore¹¹⁰ involving tax effect of ₹ 58.60 crore.

Further, in case of same assessee, while completing assessment for AY 2014-15, the Assessing Officer allowed higher amount of deduction as per FRP rates instead of allowing the deduction for sugarcane purchase at the rate claimed by the assessee. This had resulted in irregular allowance of sugarcane expenses of ₹ 11 crore involving tax of ₹ 4.97 crore. ITD's reply is awaited (June 2020).

Of 19 cases where audit noticed irregular allowance of deduction under section 36(1)(xvii) of the Act in six cases the assessee was engaged in

¹¹⁰ ₹ 180.21crore = ₹ 54.52 crore + ₹ 47.82 crore + ₹ 57.24 crore + ₹ 20.63 crore

agricultural manufacturing whereas in one case the assessee was engaged in manufacturing of power and energy as shown in table below.

Table 3.8: Irregularities under section 36(1)(xvii) of the Act as per activity/ business code.

(₹ in crore)

Business Code	Activity	Returned Income	Assessed Income	No of Cases	Tax Effect
101	Manufacturing- Agro Based Industry	0	500.86	6	30.23
114	Manufacturing- Power and Energy	0	7.6	1	3.99
118	Manufacturing-Sugar	(30.74)	591.90	12	73.53
Total		(30.74)	1100.36	19	107.75

Thus there was a potential of non-compliance or ineligible claims being made by assessee engaged in activities other than manufacture of sugar under section 36(1)(xvii) of the Act. ITD may consider linking the activity code or business code or nature of business with deduction claimed under section 36(1)(xvii) of the Act at ITR stage for monitoring activity-wise impact or sectoral impact of deductions availed under section 36(1)(xvii) of the Act and extent of tax compliance on account of this deduction that was introduced to benefit sugar manufacturing entities.

All 19 cases were assessed under scrutiny. Out of these cases, 14 cases involving returned income of ₹ 63.40 crore and assessed income of ₹ 865.05 crore were assessed under complete scrutiny. While the irregular claims of deduction indicate the extent of attempts of abuse of the provision by the assessee under section 36(1)(xvii) of the Act, the Assessing Officers also failed to examine conditions for selection of the cases for scrutiny in these cases which led to incorrect assessments and undercharge of ₹ 96.11 crore.

3.14 Summary of audit findings

- Verification by the Assessing Officers was inadequate in determining adherence to the principles of mutuality. The Assessing Officers were taking differential stands in assessing similar cases of claims for deduction under section 80P of the Act. This impacted the quality of assessments of Co-operative Societies and Co-operative Banks.
- There were instances of irregular allowance of deductions under sections 36(1)(viia), 36(1)(viii), 36(1)(xvii) of the Act and various subsections of section 80P of the Act., where, conditions specified under the said provisions were not fulfilled, involving tax effect of ₹ 694.50 crore in 649 cases.

- The major reasons for disallowance of claim of deduction were assessee either not engaged in activities listed out in the Act for Co-operative Societies or engaged in small proportion compared to principal activity or business. This entailed major risk of entities not working based on principles of mutuality, claiming benefits wrongfully and there being potential abuse of provisions applicable to Co-operative Societies.
- The Assessing Officers are adopting differential approach in allowance of deduction claimed under section 80P of the Act while completing assessments of assessee categorised as Regional Rural Banks, Land Development Banks and Agriculture and Rural Development Banks.
- While conducting scrutiny assessments, it was seen that the assessing officers did not duly examine the parameters specified by the ITD for selection of cases for scrutiny viz. 'large deductions claimed under section 80P of the Act', in 274 cases, resulting in irregular allowance of deduction.
- There is no mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The ITR does not capture the information in respect of sub-section of 80P of the Act under which the assessee claims deduction under section 80P of the Act.
- Distinct and actual claim of deduction made under section 36(1)(viiia) of the Act is not getting captured in the existing format of ITR.
- Benefits of claim of deduction as Co-operative Society and Co-operative Bank were availed of by those Co-operative Societies and Co-operative Banks that were registered as other than AOPs viz. AOP(Trust), Artificial Juridical Person, BOI, Firm etc., which was not in order.
- Among the various sub sections under which a Co-operative Society/ Co-operative Bank could avail of deductions, it was seen that there was, relatively, higher risk of non-compliance under the sub-sections 80P(2)(d), 36(1)(viiia) and 80P(2)(a)(i) of the Act, being 56.55 *per cent*, 18.18 *per cent* and 17.72 *per cent* of the total number of irregularities identified during audit, respectively.
- There was, relatively, higher propensity of irregular claims of deduction in respect of assessee engaged in banking, credit and financial services, accounting for 68.7 *per cent* of the total number of irregularities identified.

3.15 Recommendations

a) The CBDT may consider devising a Standard Operating Procedure for testing the principles of mutuality during scrutiny assessments of Co-operative Societies. It may also consider adopting a consistent approach for assessment of Co-operative Societies to address the practice of registering nominal and associate members with unequal rights as regular members, which defeat the principle of mutuality.

The CBDT stated (July 2020) that the Assessing Officers do look into details and documents which is the basic requirement for completing the assessment. However, an SOP will be issued to cover this issue. It further stated that CBDT has formulated the E-assessment Scheme 2019, where the process of assessment has been made faceless reducing the human intervention. Team based assessment procedure has been put in place to avoid the mistakes. Under this scheme the process of Review is also put in place which will ensure that the assessments by the Assessing officers are properly reviewed before the assessment orders are passed to eliminate the error if any.

Audit noticed instances where the Assessing Officers were allowing deduction under section 80P of the Act to assessees that did not meet the Co-operative principles and hence did not satisfy the principles of mutuality. Audit is of the view that devising of Standard Operating Procedure for testing the principles of mutuality during scrutiny assessments would facilitate uniformity and consistency in assessments of Co-operative Societies.

b) The CBDT may devise a mechanism to effectively monitor the nature of activities undertaken by a Co-operative Society while also verifying the incomes on which deduction is being claimed by the Co-operative Societies/ Banks to ensure allowance of claim to eligible assessee only.

The CBDT stated (July 2020) that monitoring is done through Computer Aided Scrutiny Selection once the case is selected for scrutiny assessment. During the course of scrutiny assessments, the verification of the income on which deductions is claimed by the Co-operative Societies/ Banks is undertaken by ITD. Suitable remedial action would be taken in appropriate cases if any mistake is discovered subsequently during audit. It is further proposed to incorporate these issues in the proposed SOP so that the mistakes do not occur.

Audit noticed that major reasons for disallowance of claim of deduction were on account of assessee either not engaged in activities listed out in the Act for Co-operative Societies or engaged in small proportion compared to principal activity or business. This entailed major risk of entities not working based on principles of mutuality, claiming benefits wrongfully and there being potential abuse of

provisions applicable to Co-operative Societies. The CBDT may therefore consider devising a mechanism to monitor the nature of income on which deduction is being claimed by Co-operative Societies. The CBDT may also consider making a provision in the ITR form to capture the sub-section of 80P under which the assessee claims deduction under section 80P of the Act.

c) To ensure allowance of deduction to eligible assessees only, minimise possibility of ineligible claims and for effective monitoring of claims, the activity code and status code of assessee may be linked with the sub-sections of 80P and 36(1) of the Act under which deduction is claimed at the stage of filing of income tax return. The instances where deductions claimed by assessees engaged in ineligible activities was disallowed during assessment may be used to identify activities, sector(s) and assessees to accord priority in selection for scrutiny in subsequent years. The same may also be reported to the concerned regulatory authorities (ROCS, RBI etc.).”

The CBDT replied (July 2020) that the recommendation is under consideration by TPL Division of the CBDT.

d) The actual claim of deduction made under section 36(1)(viiia) of the Act may be captured alongwith distinct figures/ details of deduction claimed on total income and rural advances in the relevant schedule of ITR forms for effective monitoring, better MIS and assessment of impact of deduction as the actual claim is not getting captured in the existing format.

The CBDT replied (July 2020) that the recommendation is under consideration by TPL Division of the CBDT.

e) The CBDT may ensure that the PAN status of the assessees claiming deductions as Co-operative Societies to be only AOPs. CBDT may review the PAN registration status and ensure uniformity in PAN registration to identify the assessees pertaining to Co-operative Societies/ Co-operative Banks, to facilitate meaningful information from data available with ITD.

The CBDT stated (July 2020) that for the purpose of Income Tax Act, 1961, Co-operative Societies are treated as Association of Persons (AOPs).

Audit noticed instances where benefits of claim of deduction as Co-operative Society and Co-operative Bank were availed of by those Co-operative Societies and Co-operative Banks who were registered as other than AOPs, viz. AOP(Trust), AJP, BOI, Firm etc., which was not in order. Audit is of the view that the CBDT may review the PAN registration status to ensure uniformity in PAN registration of

assesseees pertaining to Co-operative Sector and to ensure allowance of deduction admissible to Co-operative Societies to assesseees registered as AOPs only.

f) Class of assesseees and sections of the act under which the possibility of irregular allowance of claims were higher may be identified and monitored. ITD may devise a checklist outlining the same for use by the Assessing Officers to prevent recurrence of irregular allowance of deductions.

The CBDT replied (July 2020) that the recommendation would be considered in the SOP proposed to be issued in respect of assessment of Co-operative Societies.

g) The CBDT may examine the reasons for wide variations in the applicability of same law under similar conditions and issue directions, if required, to ensure consistency and uniformity in assessment of similar class of assesseees engaged in similar activities in Co-operative Sector. The CBDT may also co-ordinate with regulatory bodies to align the assessment of such assesseees in accordance with the categorisation under the structure of Co-operative Banking as per the regulatory bodies. The instances of ineligible assesseees claiming deductions admissible to Co-operative Societies and engaged in commercial banking business noticed during assessment procedure may be reported to the regulatory authorities (RBI, ROCS etc.).

h) The CBDT may issue SOP for assessment of claims made by sugar manufacturing Co-operative Societies under section 36(1)(xvii) to ensure that the allowance of deduction is in accordance with Government policies with respect to pricing of sugar at Central and State level.

