JYOTINDRA MEHTA
PRESIDENT

NAFCUB

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Respected Smt. Nirmala Sitharamanji

RE: Pre Budget Submission on issues of Co-operative Credit Societies

(i) Interpretation of section 80P (2)(a)(i), 80P(2)(d) and 80P (4) of Income Tax Act, 1961

(ii) Applicability of provisions of 80AC (ii), 269SS, 269T, 269ST, Proviso to section 194A (3) of Income Tax Act, 1961

(iii) Liability of GST Acts.

National Federation of Urban Cooperative Banks and Credit Societies (NACUB) is the national level body responsible for advocacy on regulations of urban cooperative banks and cooperative credit societies in India. There are 1530 urban cooperative banks and over 50,000 cooperative credit societies functioning in the Country.

While urban cooperative banks are in news now and then, the large number of cooperative credit societies, whose membership across the Country could be anywhere above 30million are serving their members who are predominantly from lower middle class or economically lower strata of the society. Almost all of them save a miniscule number of multistate societies are regulated by the state cooperative registrars. Their strength is their simple procedures, ready accessibility and providing basic financial services to those people who are not able to meet the rigorous requirements of banks to become their customers. Large number of informal entities came up in the eighteenth century to meet the needs of common man when the Colonial British regime took up to destroy the indigenous financial system that was thriving for centuries in order to break the backbone of the thriving economy and to make it dependent on the fast industrialising Great Britain. These transformed into credit societies by turn of 20th century when cooperative societies act was made. Thus, credit societies are a part of cultural ethos and they need to be preserved at all cost.

This submission is for your kind attention to the difficulties faced by co-operative credit societies which are working at very grass root level and have problems due to certain captioned provisions of the Income Tax Act, 1961 The difficulties under each of the sections is explained as under:

(i) Tax is levied by denying deduction u/s 80P (2)(a)(i) in respect of interest income on investment made in banks deposits. Such investments are made for liquidity in business and as per legal requirements of local state laws.

(ii) Tax is levied by denying deduction u/s 80P (2)(d) in respect of interest income received from deposits with co-operative banks.

(iii) Credit Societies are financial intermediaries and their business with their members is like that of a bank with its customers. However, their cash transaction are treated as though they are non financial business entities and are not permitted u/s 269SS, 269T and 269ST. Being a financial intermediary, activities of a credit society is not possible without the department considering them to be in violation of mentioned section. Such a stand by the Department will virtually kill the sector.

(iv) Draconian provision of non-availability of deduction u/s 80P as per Section 80AC (ii), if the Income Tax Return is filed after due date by Co-operative Society.

(v) TDS is deducted from interest income on bank deposit with co-operative banks in line with proviso to Section 194A (3), resulting in reducing the availability of liquid funds for operation of co-operative society.

(vi) Compliance of GST registration is to be made even on service charge income which is of a very nominal amount collected from members.

Each of the above mentioned six issues is of crucial importance for the working of credit societies and , if not rectified, they are collectively potent to ensure demise of this important segment of financial intermediation that has umbilical connection with the informal sector and with people outside mainstream banking fold.

Well thought out concessions to the entire cooperative credit sector were being given as the bulk of the clientele of this sector comprised of people of very limited income and of the informal sector.

In 2006, the Govt. of the day felt that cooperative banks had grown big and that their earnings had to be taxed, though the entire income tax paid by the all the 1530 odd urban cooperative banks put together is hardly of the order of Rs2000cr.and it was very evident that creation of reserves was one of the main avenues of augmenting capital of the cooperative banks.

However, introduction of Sec80(P)(4) was clearly meant to tax income of cooperative banks only, leaving the status of credit societies fully unaffected by the introduction of this section.

By not recognising that the credit cooperatives are distinct from other cooperatives while interpreting the sections 80P(2)(a)(i), 80P(2)(d) and 80P (4) on one hand and sections 80AC (ii), 269SS, 269T, 269ST, and proviso to section 194A (3) on the other are being interpreted in a manner that will strangulate the sector.

The following are the details of. difficulties faced section wise, and suggestions to mitigate them

1. **Interpretation of applicability of provisions of Section 80P(2)(a)(i), 80P(2)(d) and 80P(4) cooperative credit societies**

1.1 Co-operative Credit societies accept deposit from and lend the same to members and also earn interest from loans to members. It also earns interest income from deposits invested with the banks to maintain liquid funds to meet any eventuality and also to comply legal requirements. Thus, said income is attributable to business of credit society and so eligible for deduction of whole income u/s 80P(2)(a)(i) of Income Tax Act and accordingly such income is not taxed. However, in case of Totgars' Co-operative society ltd v. ITO [332 ITR 283 (SC)] held that the words of the amount of profit and gains of business in section 80P(2)(a)(i) emphasizes that the income in respect of which deduction is sought must constitute the operational income and not the other income which accrues to the society. Accordingly, it was held that interest earned by appellant co-operative society on surplus funds invested in short term deposits with banks and in government securities is not eligible for deduction u/s 80P.

Department is indiscriminately applying the above decision to all kind of co-op. societies including credit co-op. societies to disallow the deduction claimed u/s 80P(2)(a) against the income from investments without appreciation of facts as under.

i. At the first instance, the ratio mentioned in the decision in case of Totgars' Co-op. Sale Society (supra), as observed by Supreme Court itself, was confined only to the facts of the case before it & accordingly, it cannot be applied in general to all types of co-op. societies.
ii. In the case of Totgars', the Hon'ble Supreme Court had not spelt out anything with regard to operational funds in the hands of co-operative credit societies since it was applicable to co-operative sale societies only.
iii. Assessee, in Totgars' case, had admitted that it had invested surplus funds, which were not immediately required for the purpose of its business, in short term deposits; the surplus funds arose out of the amount retained from marketing the agricultural produce of the members; On the other hand, since all of liquid funds in

case of financial intermediary like cooperative credit society is at all times treated as the working funds, there cannot be any similarity.

iv. Assessee, in Totgars' case carried on two activities, namely, (i) acceptance of deposit and lending by way of deposits to the members; and (ii) marketing the agricultural produce; and that the surplus had arisen emphatically from marketing of agricultural produces. Whereas, in the case of cooperative societies that are exclusively co-op. credit societies, do not carry out any activity other than providing credit facilities to its members and that the funds are essentially operational in nature. The only fund available with the pure credit societies is deposits from its members and, thus, there are no surplus funds as such.

By considering all the above clinching dissimilarities, Ahmedabad bench of Hon'ble ITAT in case of Jafari Momin Vikas Co-op Credit Society Ltd. vs. ITO [ITA No.1491/Ahd/2012 for A.Y. 2009-10], rightly held that ratio laid down by the Hon'ble Supreme Court in the case of Totgars' Co-op Sale Society Ltd (supra) cannot be applied to the facts of the appellant credit society and accordingly deduction u/s 80P was allowed against interest income from deposits with nationalized banks.

It may be however observed that there are instances of courts interpreting otherwise therefore on account of absence of clarity, thousands of cases are pending at various appellate stages.

Important point is that intention of government could not have been anything but what is clearly spelt out in Sec80(P)(4) which unambiguously continues the existing tax benefits of cooperative credit societies. u/s 80(P). It is most likely that courts would eventually give relief to co-operative societies after long litigation process. But due to this delay, both the sides are affected in terms of waste of time and money without eventually making no appreciable contribution to the revenue.

It will go a long way in mitigating hardships of litigation expenses as well as of blocking precious funds of the thousands of cooperative credit societies, if a clear and express provision is made for not taxing interest income on bank deposits by inserting sub-section providing that "**in respect of interest income derived by co-operative credit society from investment made with banks, the whole of such income"** or CBDT instruction be issued for clear interpretation after considering intention of law.

1.2 Similarly, Section 80P(2)(d) provide that interest income received by co-operative society from investment with any other co-operative society is deductible i.e. no tax is levied on such income. However, honourable Karnataka HC in case of Principal Commissioner of Income-tax, Hubballi vs. Totagars' Co.Op. Sale Society (2017) held that interest income is taxable if received by co-operative society from co-operative bank even though co-op. bank is co-operative society. This judgement is

based on interpretation of section 80P (4) which provides that the provisions of section 80P shall not apply in relation to any co-operative bank. Number of courts have differed on this issue. The intention of section 80P (4) was for taxing income of bank and not of income of co-operative societies which receive income from investment with co-operative banks. But now, litigation have started and tax demands are raised and recoveries actions are initiated by freezing bank accounts of co-operative credit societies.

To mitigate this difficulty, it is suggested that Sec. 80P(4) which reads as "Section 80(P) shall not apply in relation to any co-operative bank." may be amended to read as "Section 80(P) shall not apply in relation to the income of any cooperative bank"

2. Applicability of Section 269SS & Section 269T to Cooperative Credit Societies

2.1 Co-operative credit societies are expected to provide facilities to their members in same way as in case of banks and so they accept deposits from members in cash and also repay deposit in cash. Society is also required to give loans in cash to their members to fulfil immediate needs. But as per section 269SS, no person, subject to certain exceptions can accept loans or deposit of money otherwise than by account payee cheque or draft and in similar way as per section 269T of Income Tax Act. Deposit cannot be repaid otherwise than by cheques or draft. The applicability of section 269SS & 269T is not only limited to single cash transaction of Rs. 20,000/- but it covers even aggregate of cash transactions which exceeds Rs. 20,000/-.

2.2 Various courts have interpreted the law that the exception is provided only for banks and as co-operative credit societies are not banks hence liable for penalty on cash transactions. The repercussions of this interpretation will virtually cripple the cooperative credit societies, since their customers who are mostly from informal sector do most of their transactions in cash. Even though they may individually be of small amounts, in aggregate they add up to amounts which will attract penalty. It is imperative that credit societies are treated on par with banks in compliance of Section 269SS and 269T. The banks are exempted from Section 269SS & 269T and so banks are accepting and repaying deposit in cash. But co-op. credit societies are not fall in the list of exceptions of Sec. 269SS and 269T. Co-operative credit societies are subject to control of co-operative registrar and also subject to audit by auditor appointed by co-operative department of state government. KYC documents of all the members have to be obtained by the society and if the society found making mischief of accepting deposit without KYC,

tax can be levied on such cash deposit u/s 68. The intention of Section 269SS and 269T is only for the

2.3 Curbing practice of reflecting huge cash deposit found during search actions. So, applying sections 269SS and 269T to co-operative credit societies is not in consistent with intention of the law.

It is therefore suggested that co-operative societies be treated at par with co-operative banks and for this purpose and co-operative credit societies be added in exceptions provided in item (b) of first proviso to Section 269SS and exceptions provided in item (ii) of second proviso to Section 269T.

3. **Interpretation of applicability of Section 269ST to cooperative credit societies**

Co-operative Society give loan of even more than 2 lacs to its members and repayment of loan is made by members in cash even by way of instalments of less than 2 lacs and in all such situations, violation of section 269ST occurs. Cash recovery of instalment of loan is essential for financial activity but due to Sec. 269ST, it is difficult for the credit society to do activity of credit facility with the members. It is worth to mention that Co-operative banks are covered in exception in item no. (i)(b) of proviso to section 269ST of Income Tax Act but co-operative societies are not included in exceptions. So, inclusion of co-operative society along with co-operative bank should be made and remove undue hardship on credit society.

Alternatively, Government may issue notification as Government is empowered by item no. (iii) of proviso to sec. 269ST and Government can exclude any class of person from the applicability of provisions of section 269ST.

4. **Denial of deduction u/s 80P if income tax return is filed after due date, as per Section 80AC(ii)**

Co-operative societies operate at grass roots level working mainly for those people who do not get easy access to banks and are working in those areas where commercial and co-operative banks are not able to work effectively. Such co-operative societies are managed by people, who are not very well acquainted with all income tax provisions. They work at very small levels with low administration cost. Many of them are not aware about the legal position that the benefit of deduction u/s. 80P which get lapsed, if the filing of income tax return gets delayed beyond due date and also charged with late filing fees and penal provisions for late
filing of return. This provision is very harsh particularly small co-operative societies due to no basic exemption limit to co-operative societies. Even those cooperative credit societies who have to pay minimal or no income tax. Inadvertent delay to file return in

time by these societies would result in crippling penalty of denial of deduction u/s 80(P), which is rather harsh.

Considering this hardship, **Section 80AC (ii) may be amended by excluding deduction u/s 80P from 80AC (ii).**

5. **Applicability of proviso to Section194A(3) to cooperative credit societies:**

5.1 Up to F.Y. 2019-20, Co-operative banks were not liable to deduct TDS on interest payment made to co-operative societies but due to insertion of proviso to Section 194A (3) by Finance Act 2020 co-operative banks whose receipts are exceeding 50 Cr., they are liable to deduct TDS on interest payment to co-operative credit society.

5.2 This created hardship to co-operative society; their funds are blocked in form of TDS which is deducted by co-operative banks. Co-operative credit society can invest only in scheduled co-operative bank or district co-operative bank which are liable to deduct TDS and as per Section 80P(2)(d), the interest received by co-operative society from co-operative bank is not taxable and so to avoid tax deduction from interest income, co-operative society have to approach to ITO

5.3 (TDS) for obtaining no TDS certificate. We know that charter of government is for public convenience and government never desire to create such hardship unless there is revenue to government. So, it is requested that the proviso of section 194A(3) be deleted.

6. Applicability of provisions of GST Act:

6.1 Applicability of GST to Co-op. Credit Societies

Interest income is exempt supply by virtue of the entry no. 27 of Notification no. 12/2017- Central Tax (Rate). This notification has prescribed the list of service exempted from GST. As the interest is covered in the notification related exemption on services, it is no doubt that interest is also covered under the scope of supply. And so interest is also to be considered in the definition of aggregate turnover.

Now, Co. Op. Credit societies have mainly interest income and very nominal amounts of service charges from the members of the societies. If the societies are having only interest income of Rs. 20 lakh or more then also societies are not liable to take registration by taking benefit of Sec. 23(1)(a) of CGST Act as it is engaged exclusively in the supply of service wholly exempt from tax. But due to having nominal amounts of service charges from members (which are taxable) mainly in nature of reimbursement or compensatory, societies are required to obtain registration under GST as per Sec. 22 and comply with all the requirements of filing various returns under GST Act.

6.2 In the most of the cases, liability of GST arises of very nominal amount but due to requirements of compliance of procedure prescribed under GST rules, high

professional charges are to be paid and in case of default, heavy late fees and penalties are levied. So, it is undue hardship to the society without any revenue to government.

6.3 So, to remove this difficulty, Government may issue notification under sec. 23(2) or alternately, Government may consider issuing notification u/s. 9(3) and including the services of Co-op. credit society in the category of supply of services on which tax is to be paid on reverse charge basis by the recipient of the service.

We once again appeal to you to take above difficulties of thousands of cooperative credit societies that cater to the financial needs of economically vulnerable sections of the society, with empathy and make changes in the relevant sections of Income Tax that would be beneficial to these societies and their members. In this context we hope that our suggestions would be favourably considered in the interest and welfare of common men.
The Federation would feel happy and privileged to be asked by the Government to further elaborate our points of view on any of the issues.

With kind Regards,

Yours Sincerely,

(Jyotindra Mehta)

To,
Smt. Nirmala Sitharaman
Hon'ble Union Finance Minister
New Delhi.