

A COMMISSIONER OF INCOME TAX, LUCKNOW
v.
U.P. COOPERATIVE FEDERATION LTD.

FEBRUARY 10, 1989

B [R.S. PATHAK, CJ AND RANGANATH MISRA, J.]

C *Income Tax Act, 1922: s. 14(3)(iii)/Income Tax Act, 1961: S. 80P (2)(d) —Assessee—Apex Cooperative Society—Cash security—Furnished to manufacturer Cooperative Society under agency agreement—Loans advanced to member cooperative societies for carrying on business—Whether investments—Interest earned thereon—Whether entitled to exemption from tax.*

Words and Phrases: 'Investment'—Meaning of—s. 14(3)(iii), Income Tax Act, 1922.

D Clause (iii) of Section 14(3) of the Income Tax Act, 1922 exempts interest and dividends derived by a cooperative society from its investments with any other cooperative society, from payment of tax.

E The respondent-assessee, an apex body having as its members various District Co-operative Societies, District, Co-operative Banks and some Government and other co-operative Societies within the State of U.P., was appointed as one of the wholesale dealers under clause (1) of the agency agreement entered into with a co-operative sugar factory for distribution of sugar produced by the latter during the crushing seasons 1958-59 and 1959-60. Simultaneously with the execution of the agreement it furnished a cash security of Rs. Two lakhs to the manufacturer
F under clause (20) of the said agreement for the period of two years, which was to carry interest at the rate of 4½ per cent per annum.

G In pursuance of a separate agreement entered into between it and the State Government the assessee undertook to arrange for lifting, handling, storing and distributing to the retailers the stock of sugar released by the Government of India. In an yet another agreement entered into between the assessee and member societies the latter undertook to work as agents for the wholesale distribution of sugar in their districts. Since they were not in a position to arrange the entire finance for the business the assessee agreed to arrange for the same. The money thus invested in the business was to earn interest at the rate of 6 per cent
H per annum.

In the accounting year in question the Income Tax Officer rejected the claim of the assessee for deduction, on ground of statutory exemption under s. 14(3) of the Act, of the amounts of interest received respectively from the cooperative Sugar factory on the cash security deposit and from member societies on temporary loans advanced for financing business. The Assistant Appellate Commissioner rejected assessee's contention. The Appellate Tribunal rejecting the former claim took the view that the amount of interest received on cash security furnished by the assessee for carrying on the sugar agency business could not be said to be interest from securities or investments as understood under s. 14(3)(iii) of the Act. Rejecting the latter claim it held that the amount on which interest had been earned did not constitute investment and, therefore, was not covered by s. 14(3)(iii) of the Act. But the High Court accepted the claim in regard to both the amounts.

Disposing of the appeal by the Revenue, the Court,

HELD: 1.1 The Tribunal did not err in holding that the amount received as interest on the cash security from the cooperative sugar factory was not covered under s. 14(3)(iii) of the Income Tax Act, 1922. [591B]

1.2 The High Court failed to take note of the fact that the sum of Rs. Two lakhs had been given a security and the arrangement entered into between the assessee and the cooperative sugar factory stipulated payment of interest of 4½ per cent per annum. This sum was repayable to him on the expiry of the period fixed in the agreement after adjustment of accounts. It could not, therefore, be said to be an investment. The amount of interest earned thereon thus represented only interest on the security deposit and could not be mixed up with the other sums received by the assessee in course of carrying on its business. It was not available to be exempted. [589G; 590F]

2.1 The amount of interest received by the assessee on advances to its members was income from sugar business and was, therefore, exempt under s. 14(3)(iii) of the Act. [595B]

2.2 The money provided by the assessee was by way of investment with other cooperative societies. If this money had not been made available the business as stipulated under the scheme could not have been carried out and perhaps there would have been no business. This funding to other cooperative societies was necessary to generate profits, and under the agreement interest has been earned. The High Court was,

- A therefore, right in its conclusion that no tax was payable on this income from sugar business. [594F-G]

CIVIL APPELLATE JURISDICTION: Civil Appeal No. 1228(NT) of 1975.

- B From the Judgment and Order dated 29.11.1973 of the Allahabad High Court in I.T. Reference No. 842 of 1971.

V. Gauri Shankar, Ms. A. Subhashini, C.V. S. Rao, Mrs. Sushma Suri, P. Parmeshwaran and M.K. Sashidharan for the Appellant.

- C Harish N. Salve and Parveen Kumar for the Respondent.

The Judgment of the Court was delivered by

- D RANGANATH MISRA, J. This appeal at the instance of the Revenue is by special leave. Two questions out of six referred by the Income Tax Appellate Tribunal, Allahabad, survive for consideration in this appeal and these are:

- E (1) Whether on the facts and in the circumstances of the case, and on a true interpretation of the agreement, the Tribunal erred in holding that the sum of Rs.9,000 received as interest from Bazpur Cooperative Sugar Factory Ltd. is not covered under Section 14(3) of the Income Tax Act?

- F (2) Whether on the facts and in the circumstances of the case, and on a true and correct interpretation of the various clauses of the agreement, the sum of Rs.51,295 and Rs.58,937 received as interest on advances would not be assessee's income from coal and sugar business and would thus be exempt under Section 14(3) of the Income Tax Act, 1922?

- G At the hearing it has been clarified by counsel for both parties that in the second question referred to above, the dispute is confined to the sum of Rs.51,295 only.

- H The relevant assessment year is 1961-62 corresponding to the accounting year ending with 30th June, 1960. The assessee is a co-operative society registered under the Cooperative Societies Act, 1912. This being an apex body, its members are various District Cooperative Societies, District Cooperative Banks and some Govern-

ment and other cooperative societies within the State of Uttar Pradesh. The principal object of the Society is to regulate the distribution and supply of items like coal, sugar, cloth etc. through the member cooperative societies.

In the year in question, the assessee *inter alia* maintained that the income earned on the various advances made by it to the member societies was entitled to exemption under Section 14(3) of the Income Tax Act, 1922. The Income Tax Officer while rejecting the claim of deduction on the ground of exemption on several heads included interest of Rs.9,000 received from Bazpur Cooperative Sugar Factory Ltd. and a sum of Rs.51,295 received by way of interest from various cooperative societies on temporary loans for financing sugar business at the rate of 6 per cent on the amount given as loan as taxable items. The two questions which have survived for decision in this appeal relate to refusal of these two deductions on the ground of statutory exemption. The stand of the assessee had not been accepted by the Appellate Assistant Commissioner and the Income Tax Appellate Tribunal but the High Court has accepted the claim in regard to both the amounts.

The High Court dealing with the amount of Rs.9,000 held:

“The Tribunal considered the claim for exemption in respect of amount of Rs.9,000 received by the assessee from the Bazpur Cooperative Sugar Factory and held that this represented the interest received on the cash security of Rs.2,00,000 which was furnished by the assessee for carrying on the sugar agency business, and as such it could not be said that it was interest from securities or interest from investments and as such rejected the claim made in respect of this amount under Section 14(3)(iii) of the Act.”

The High Court considered the exigibility of the sum of Rs.9,000 to tax analogously with the taxability of the other sum and did not pointedly take note of the fact that the sum of Rs.2,00,000 had been given as security and the arrangement entered into between the assessee and the Bazpur Cooperative Sugar Factory stipulated payment of interest of 4½ per cent per annum.

We may refer here to clauses (1) and (20) of the agency agreement:

A “1. That the manufacturer hereby appoints the
Agent as one of their two agents for the whole of the Indian
Union for the sale of sugar produced by the manufacturer
during the crusing seasons 1958-59 and 1959-60 and the
Agent hereby agrees to act as such agent in the said area on
the terms mentioned herein. The manufacturer hereby
B undertakes not to appoint more than two agents as afore-
said.”

C “20. The Agent shall simultaneously with the execu-
tion of this agreement furnish a cash security of Rs. Two
lakhs to the manufacturer for a period of two years
(irrespective of previous determination of the agreement
for any cause whatsoever) to ensure against due compli-
ance by the agent of the terms hereof; such security shall
carry interest at the rate of $4\frac{1}{2}$ per annum. Such security
shall be repayable with interest to the agent within one
month of the expiry of the period fixed in the agreement
D after adjustment of accounts between the parties. The
manufacturer shall have the option to realise from the said
security money all losses suffered and/or expenses incurred
and not paid by the Agent in pursuance of the provisions of
this agreement. If the said security shall fall short of Rs.
Two lakhs at any time, the deficiency therein shall be made
E good by the Agent within 15 days of the notice in writing
from the manufacturer.”

The amount of Rs.9,000 thus represented only interest on the
security deposit and could not be mixed-up with the other sums
received by the assessee in course of carrying on its business. We do
F not think the High Court was right in concluding that this amount of
Rs.9,000 was available to be exempted under any of the clauses of
Section 14(3) of the Act.

G Admittedly, the assessee's claim does not come under clause (i)
of Section 14(3). Unless this sum is covered by Section 14(3)(iii),
there would be no exemption. The sum of Rs. Two lakhs given as
security in terms of the agreement was not an investment and, there-
fore, the amount of Rs.9,000 received by way of interest does not
come within the purview of clause (iii). Mr. Salve for the assessee-
respondent has fairly conceded that it would be difficult on his part to
press the claim of the assessee for exemption in respect of this sum. The
H conclusion of the High Court in regard to this amount has, therefore,

to be reversed and the stand of the Revenue to the effect that this amount represents taxable income has to be accepted.

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Our answer to the first question, therefore, is that on the facts and in the circumstances of the case and on a true interpretation of the agreement, the Tribunal did not err in holding that the sum of Rs.9,000 received as interest from Bazpur Cooperative Sugar Factory Ltd. was not covered under Section 14(3) of the Income Tax Act.

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We shall now deal with the other question. Dealing with it the High Court stated:

“The facts relating to the case for exemption in respect of the two amounts of Rs.51,295 and Rs.58,937 (the second amount is no more in dispute) covered by question No. 3 may be stated. We shall begin by referring to facts relating to advances made in relation to the sugar business. The assessee was appointed as one of the wholesale dealers for distribution of sugar in this State. It had, in pursuance of an agreement entered into between it and the State Government, to arrange for lifting, handling, storing and distributing to the retailers the stocks of sugar released by the Government of India. The District Cooperative Development Federations of Deoria, Garhwal, Tehri Garhwal, Pilibhit, Etawah and Allahabad, entered into agreements with the assessee to work as agents for the whole sale distribution of sugar in their Districts. A sample of the agreement entered into between the assessee and these various District Cooperative Development Federations The assessee was to make necessary investments by way of payment of price of sugar to be procured from the factories and also to pay the administrative charges incurred for the distribution of sugar. This administrative charge was, however, recouped by the agents and paid over to the assessee. The delivery of the sugar from the various factories was to be taken by the various District Cooperative Development Federations which had entered into agreements with the assessee on behalf of the assessee as soon as the release orders were issued by the Government of India. The sugar so received was to be stored in godowns and was to remain under the custody of Godown-keepers of the assessee or the bankers of the assessee. The salaries of the Godown-keepers and the Chowkidars

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A appointed for safe custody of the stocks of sugar were to be paid by the agents”

B “The sugar so stored was to be released to the agents as and when required by them on full payment of its price at the rate fixed by the State Government or the District Magistrate concerned. The stocks of sugar taken over by the agents was to be sold by them to retailers, and permit-holders who were to be nominated by the District Magistrate or the officer authorised by him. The whole salers’ margin on the sugar sold for the period beginning September 1959 onwards with which we are concerned was Rs.2.06 Naya Paisa per bag. The share of the assessee and the District Cooperative Development Federations in this amount is set out in clause 18 of the agreement”

The High Court extracted the terms and came to hold:

D “It appear from a letter dated 30th September, 1959, that the various District Cooperative Development Federations were not in a position to arrange the entire finances for the business and accordingly the assessee agreed to arrange for finances of the business on certain terms and conditions. The terms and conditions on which the finances were to be arranged may be extracted:

(1)

(2)

F (3)

(4)

(5) The money invested in the business will earn interest at 6 per cent per annum.

G (6)

H “It will be seen that money which the assessee made available to the District Cooperative Development Federations was to be utilised for the purchase of the stocks of sugar which the District Cooperative sold as agents of the asses-

see. In the accounting, year in question, the assessee realised the following amounts of interest from the District Co-operative Development Federations mentioned below:

Name	Amount	
i) District Cooperative Development Federation Ltd., Deoria.	4,694.16	B
ii) District Cooperative Development Federation Ltd., Garhwal.	15,797.60	
iii) District Cooperative Development Federation Ltd., Tehri Garhwal	5,557.50	C
iv) District Cooperative Development Federation Ltd., Etawah.	2,984.24	
v) District Cooperative Development Federation Ltd., Pilibhit.	2,616.21	D
vi) District Cooperative Development Federation Ltd., Allahabad.	19,645.53	
Total	<u>51,295.24</u>	E

Dispute covered by the second question to be answered is over this amount. The Income Tax Officer as also the two appellate authorities relying upon the decisions of the Bombay High Court in *Sir Chinu Bhai Madav Lal v. Commissioner of Income Tax*, 37 I.T.R. 210 and *Commissioner of Income Tax, Bombay City v. Bombay State Cooperative Bank Ltd.*, 59 I.T.R. 31 held that the amount on which interest had been earned under the agreement did not constitute investment and, therefore, was not covered by Section 14(3)(iii) of the Act.

Section 14(3) provides that tax shall not be payable by a cooperative society in certain situations. Clause (i) under its six sub-clauses refers to specific classes of cooperative societies in whose case there is total exemption. Clause (ii) exempts income in respect of profits and gains of business of cooperative societies not covered by clause (i) upto Rs.15,000. Clause (iii) exempts interest and dividends and income derived from investments with any other cooperative society. Clause

A (iv) exempts income derived from letting of godowns or warehouses for storage, processing or facilitating the marketing of commodities while Clause (v) exempts interest on securities chargeable under Section 8 or any income from property chargeable under Section 9, where the total income of the cooperative society of specific type mentioned therein does not exceed Rs.20,000.

B There can be no dispute on the conclusion reached by the High Court that the money provided by the assessee was by way of investment. In fact, if this money had not been made available the business as stipulated under the scheme could not have been carried out and perhaps there would have been no business. "Investment" has not been defined in the Act. P. Ramanatha Aiyar's The Law Lexicon, (Reprint Edition 1987) states:

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"The term *invest* is used in a sense broad enough to cover the loaning of the money but is not restricted to that mode of *investment* or loans made on commercial paper. The word *invest* has been judicially defined as follows:

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'To place property in business; to place so that it will be safe and yield a profit. It is also commonly understood as giving money for some other property (as) investing funds on lands and houses. *Investment* means in common parlance, putting out money on interest, either by the way of loan, or by the purchase of income producing property ...'

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In the facts of the present case the money provided by the assessee was necessary to run the business and generate profits; under the agreement interest has been earned. In the peculiar situation appearing in the case as found by the High Court the provision of money by the assessee, the purpose for which the money was provided, the stipulation for earning of interest, were relevant considerations to be taken into account and it becomes difficult to take a view different from that of the High Court that the funding was investment and under the agreement interest has been earned. Admittedly the finding was the cooperative societies. In our opinion, therefore, the amount of Rs.51,295 squarely came within Section 14(3)(iii) of the Act. The High Court, therefore, was right in its conclusion that no tax was payable on the said amount. We would like to point out that under Section 14(3) provision has been made to extend certain advantages to the cooperative societies in order that the legislative purpose of providing incentive to the cooperative movement may be fulfilled. The High Court

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was right in holding that the provisions contained in Section 14(3) should be liberally construed. A

Our answer to the second question, therefore, is on the facts and in the circumstances of the case and on a true and correct interpretation of the various clauses of the agreement, the sum of Rs.51,295 received as interest on advances in the assessee's income from sugar business was exempt under Section 14(3) of the Income Tax Act, 1922. B

There shall be no order for costs in this appeal as success is divided.

P.S.S.

Appeal disposed of. C