



**IN THE HIGH COURT OF KARNATAKA
DHARWAD BENCH**

DATED THIS THE 26TH DAY OF FEBRUARY 2016

PRESENT

THE HON'BLE MR. JUSTICE H.BILLAPPA

AND

THE HON'BLE MR.JUSTICE P.S.DINESH KUMAR

I.T.A.NO.100069/2015

BETWEEN

1. THE COMMISSIONER OF INCOME TAX
CENTRAL REVENUE BUILDING
ATTAVAR, MANGALURU
2. THE INCOME TAX OFFICER
WARD-2, SANTERI KRUFAPA BUILDING
HABBUWADA, KARWAR ... APPELANTS

(BY SRI Y V RAVIRAJ, ADVOCATE)

AND

THE NAGARBAIL SALT-OWNERS
CO-OPERATIVE SOCIETY LIMITED
SANIKATTE, GOKARNA, KUMTA-581 326
PAN: AAAFT6229J ... RESPONDENT

(BY SRI ASHOK KULKARNI &
SRI H R KAMBIYAVAR, ADVOCATES)

THIS ITA IS FILED U/S.260A OF THE INCOME-TAX ACT
1961, PRAYING TO FORMULATE THE SUBSTANTIAL
QUESTION OF LAW STATED ABOVE AND TO ALLOW THE
APPEAL AND SET ASIDE THE ORDERS PASSED BY THE
INCOME TAX APPELLATE TRIBUNAL, PANAJI BENCH, PANAJI,
IN ITA NO.252/PNJ/2014, DTD: 23.01.2015 FOR THE
ASSESSMENT YEAR 2007-08 AND CONFIRM THE ORDER

PASSED BY THE INCOME TAX OFFICER, WARD-2, SANTERI KRUJAPA BUILDING, HABBUWAD, KARWAR.

THIS ITA HAVING BEEN HEARD AND RESERVED FOR JUDGMENT, THIS DAY, P.S.DINESH KUMAR. J., PRONOUNCED THE FOLLOWING:-

JUDGMENT

This appeal is presented by the Revenue by raising the following substantial question of law:

“Whether the Tribunal is right in law, considering the facts and circumstances of the case in holding that the respondent society is managing its activity on behalf of its members in the most beneficial way by selling the products manufactured by the members, without appreciating that the assessing authority has clearly brought on record that there is no active participation of members in its activities and the respondent society is carrying a commercial activity for the purpose of earning profit and as such the findings of the Tribunal are perverse?”

2. Heard Shri Raviraj, learned standing Counsel for the Revenue and Shri Ashok Kulkarni, learned Counsel for the respondent.

3. Shri Y.V.Raviraj has presented his case with following submissions:

- i) Respondent is a Co-operative Society registered under the provisions of the Karnataka Co-operative Societies Act, 1959. The aims and objects of the Society are mentioned in detail in Chapter IV of the approved Bye-laws of the Society;
- ii) The members of the Respondent-Society are 'Maliks' who are owners of land (Agar) on which salt is manufactured. The Society was formed *inter alia* to acquire from the 'Maliks' the rights and to manufacture salt and its by-products;
- iii) In terms of the Bye-laws and other arrangements, the individual pieces of lands belonging to the members vested with the Society. Society purchased and installed necessary plants and machinery to manufacture salt and other by-products;

- iv) Society manufactures and sells salt and other by-products. The sale proceeds were being transferred to an account called 'Distributable Pool Fund Account' for distribution among the members of the Society. After such transfer, the Society would offer remaining income to tax;
- v) For the assessment year 2007-08, a return of income was filed on 31.10.2006, returning a sum of Rs.1,20,170/- being the loss carried forward. The income was computed at Rs.NIL after claiming deduction of Rs.50,000/- under Section 80P(2)(c)(ii) of the Income Tax Act, 1961 ('the Act' for short) as per the Profit and Loss account;
- vi) A notice under Section 148 was issued on 25.3.2013. Respondent-Society filed its reply stating that the income filed on 30.10.2006 declaring a total income of Rs.NIL for the assessment year 2007-08 was correct and the

same may be treated as its income. The case was taken up for scrutiny and a notice under Section 143(2) of the Act was issued. Assessee-Society was represented by one Shri Anil Shantharam Nadkarni, Manager of the Society and Shri R.V.Hublikar, an Income Tax Practitioner. They filed copies of Bye-laws, brief notes about the activities of the Society, certified copies of final accounts - Profit & Loss Account, Balance Sheet, Schedules showing Debtors and Creditors, Audit report under Section 44AB, copies of the VAT returns, details of cash sales, computation of income etc. It was observed by the Assessing Authority that there was no certificate by the Chartered Accountant to the effect that the statement was drawn as per the Audit Report under Section 44AB of the Act. The Chartered Accountant was summoned and a statement was recorded. To a specific question as to whether transfer to 'Distribution Pool Fund Account' is considered

as expenditure, the Chartered Accountant had refused to answer and sought time to furnish an explanation. Subsequently, an explanation was sent by him by an Email. The Assessing Authority held that the reply by the Chartered Accountant was not in accordance with his report under Section 44AB and further that he had hesitated to comment on the deduction claimed as 'Transfer to Distribution Pool Fund Account'.

- vii) Based on material on record and after hearing, the Assessing Authority passed an Assessment Order dated 30.12.2013 under Section 143(3) read with Section 147 of the Act and held that the assessee had an income of Rs.1,57,93,500/- and accordingly, liable to pay an Income Tax of Rs.47,35,050/-. After adding surcharge, cess, interest etc., the Assessing Authority held that Assessee Society was liable to pay a total amount of Rs.87,41,889/-;

viii) On appeal by the Assessee, the first Appellate Authority namely, the Commissioner of Income Tax (Appeals), by his common order dated 2.4.2014, placing reliance on the judgment of the Hon'ble Supreme Court in the case of *M/s. Radhasoami Satsang, Saomi Bagh, Agra v. Commissioner of Income Tax* reported in (1992)1 SCC 659,¹ allowed the appeal in part by holding that the Bye-laws cannot be segregated and read in isolation to hold the income generated was the income of the appellant-Assessee. The said order was challenged before the Income Tax Appellate Tribunal, Panaji Bench ('ITAT' for short) and the same stood dismissed by the impugned order. Hence, this appeal.

4. Assailing the legality and correctness of the orders passed by both the First Appellate Authority and the ITAT, Shri Y.V. Raviraj, vehemently contended that a plain reading of Bye-laws and particularly Bye-laws 4(a),

¹ (1992)1 SCC 659

(b), (c), (d) & (k) would make it amply clear that the Assessee-Society had acquired 'Maliks' rights to manufacture salt from the members. Society had also installed suitable plant and machinery to manufacture salt and its by-product. It is not in dispute that the entire quantity of salt and the by-product are sold by the Society. Thus, Society having acquired the 'Maliks' rights had established facility to manufacture salt and its by-product and carrying on the said business. He contended that Society is a 'juristic person' registered under the provisions of the Karnataka Co-operative Societies Act and managed by a Governing body. Manufacturing and sale is undertaken as a business venture by the assessee Co-operative Society and therefore the income earned in the course of business is liable to tax under the Act.

5. He further submitted that the Society was required to get the accounts audited under Section 44AB of the Act. The fact that the Chartered Accountant refused to answer the questions and particularly, the relevant

question with regard to the status of funds transferred to the Distribution Pool Fund Account and subsequently, forwarding his explanation in tune with the stand taken by the Society is a sufficient piece of evidence to conclusively infer that the Chartered Accountant had serious reservations with regard to such transfer of funds to the Distribution Pool Fund.

6. He further submitted that the order passed by the First Appellate Authority is bereft of any cogent reasons. The CIT had misdirected himself with regard to the Bye-laws of the Society and came to an erroneous conclusion while upholding the argument advanced on behalf of the Society that the Bye-laws could not be segregated and read in isolation leading to a conclusion that the income generated was the income of the Society. The ITAT also fell in an error in accepting the arguments of the Assessee. Amplifying his argument, he submitted that a plain reading of the order passed by the ITAT would show that the Society's argument was in two folds. Firstly, that, initially the Society was for the limited purpose of selling

the products manufactured by the members in a profitable way. Secondly, that there was no change in position and the Society was functioning with the same purpose even during the assessment years in question. He submitted that the second part of the argument is *ex-facie* fallacious and self-defeating because the Society had taken an inconsistent and factually incorrect stand with regard to the second aspect. Both the CIT and the ITAT lost sight of the fact that the Society was indeed manufacturing and selling salt and its by-products after acquiring 'Maliks' rights from its members.

7. In sum and substance, learned Counsel for the Revenue submitted that this is a case in which the Assessee-Society being a juristic person was carrying on the business both 'manufacturing' and 'selling' salt and its by-products. It was transferring funds to the Distribution Pools Fund and offered only the remaining income to tax. Therefore, the orders passed by the CIT and ITAT are unsustainable in law and deserve to be set aside. Accordingly, he prayed for allowing this appeal.

8. Per contra, Shri Ashok A.Kulkarni, learned Counsel for the Assessee-Society supporting the impugned judgment of the ITAT submitted that the Assessee-Society came into existence, pursuant to the orders passed by the Government of India, on the advise of the Salt Expert Committee. The said Salt Expert Committee having foreseen the difficulties of individual holders of small units had suggested that a merger either under the Government control or preferably under a Co-operative sector appeared to be a sole remedy to save them of their uneconomical size and unfavourable climatic conditions. He contended that the philosophy of Co-operative movement is to augment community resources with an aim and objective to achieve maximum benefit to the members of the Society. Therefore, the Society was justified in transferring the funds to the Pool for further distribution among the members. This practice was in vogue for several years and to be precise, even prior to the Karnataka Co-operative Societies Act coming into force. Therefore, a notice under Section 148 and all proceedings thereon by the Assessing

Authority is not only misconceived but hit by doctrine of *res judicata*.

9. Shri Kulkarni adverting to Chapter-XVI of the Bye-laws submitted that the income of the Society would accrue from levy of commission, collection of interest on loans, collection of rents, and collection of service charges. Therefore, it was erroneous on the part of the Assessing Authority to include any other income as income of the Society. In support of his contentions, he placed reliance on the few judgments and prayed for dismissal of the appeals.

10. We have given our careful consideration to the rival contentions urged at the bar, perused the records and the rulings cited. At the outset, it is relevant to peruse the Bye-laws of the Society. Chapter-III of the Bye-laws deals with the interpretations. 'Malik' and 'Agar' are defined as under:

“ *“Malik” – means a person owning jointly or severally jointly or having an interest in agar in the Nagarbail Saza, Sanikatta on the date of the*

Registration of this Society whether he be Khatedar or not and shall be deemed to include his heirs, successors and assigns and a receiver appointed by a competent Court. Record of Rights may also be taken into consideration as evidence.”

“ “Agar” - means land on which salt is manufactured in the Nagarbail Saza which includes Narnapur Salt Works.”

11. Chapter-IV defines the aims and objects of the Society. The salient objects of the Society are as follows:

“a) to acquire from the Maliks the right of manufacturing salt in the nagarbail Saza, Sanikatta and to manufacture salt and other by-products in these areas on Co-operative basis.

c) to consolidate and remodel the salt works so as to manufacture salt and by-products economically and on a scientific basis, and to manufacture table salt and high purity salt.

k) to purchase and instal suitable plant or any other machinery required in connection with the manufacture of salt and by-products or any subsidiary works undertaken.

l) to pay on behalf of the members the assessment and mulgeni rent in respect of the individual areas included in the salt works which will be a first charge on a produce of the individual members.

q) to sell the salt and by-products either directly or through agents.”

12. Chapter-VI deals with the membership and shares. In terms thereof, no person other than a 'Malik' defined in Bye-law No.3 can be admitted as a member. Chapter-VIII deals with General Body Meeting, Chapter-X with the Supervising Council and Chapter-XI with the Managing Committee. In terms of Chapter XIII, a Chairman, a Vice Chairman and a Manager shall be the officers of the Society. Under Clause-75, these officers are subject to control of the Managing Committee. Chapter-XVII deals with expenses. It is noticed that deduction towards depreciation of machinery, building, etc. as determined in accordance with the expert advise is described under the head 'expenses'. The General Body is authorised to distribute the 'net profits' of the Society under Chapter-XVIII. During the course of the argument,

though transfer to the Distribution Pool Fund before offering to tax was sought to be justified as it is meant for benefit of members of Co-operative Society, no satisfactory explanation was forthcoming, It was not pointed out as to under what provision or Bye-law, the transfer of funds is authorised to the 'Distribution Pool Fund'. As noted herein, Bye-laws are exhaustive in nature and there is no provision in the Bye-law to transfer the fund to the Distribution Pool for onward payment to the members. The provisions made towards depreciation of machinery, building etc. are sufficient indications to infer that the Bye-laws were framed with clear intention in mind to acquire the 'Malik' rights of the persons who were holders of land ('Agar'), to manufacture and sell salt and its' by-products.

13. It is not in dispute that the assessee-Society is in control of the lands and paying the 'Moolageni' or the lease rent charges. It is also not in dispute that the society manufactures salt and its by-products and sales are effected in the name of the Society.

14. Assessee – Society is a juristic entity having been registered under the Co-operative Societies Act and managed by its office bearers and the Governing body in accordance with the approved Bye-laws.

15. Learned Counsel for the Revenue has relied upon the judgment in the case of *Radhasoami Satsang*¹ to contend that the doctrine of *res-judicata* does not apply to the income tax proceedings. He has relied upon the following passage in support of his contentions.

“We are aware of the fact that, strictly speaking, res judicata does not apply to income-tax proceedings. Again, each assessment year being a unit, what is decided in one year may not apply in the following year but where a fundamental aspect permeating through the different assessment years has been found as a fact one way or the other and parties have allowed that position to be sustained by not challenging the order, it would not be at all appropriate to allow the position to be changed in a subsequent year.”

1. (1992)1 SCC 659

The law is fairly well settled that the doctrine of *res-judicata* does not apply to the income tax proceedings. However, we hasten to add that the Revenue cannot keep shifting its stance every now and then to the disadvantage of the assessee. But in the instant case, it is for the first time that the Revenue has issued a notice under Section 147 of the Act and adjudicated after hearing the Assessee-Society.

16. Learned Counsel for the Assessee-Society has placed reliance on the following judgments in support of his contentions:

1. *Commissioner of Agricultural Income Tax v. M.L.Bagla*, reported in (1971)80 ITR 173:

Placing reliance on the following portion of the above judgment at page 175;

..... “The High Court, agreeing with the view, observed that the association of individuals holding property was liable to tax only if it held the lands as an owner, trustee,

receiver, administrator or executor or in many other capacity recognised by law.”

learned Counsel for the Assessee contended that admittedly, the Society was not holding the land/s in question in its capacity as either an owner or a trustee, receiver, administrator or executor referred to in the above passage. Therefore, the ratio of the said judgment is squarely applicable to the facts of this case. Consequently, the appeal filed by the Revenue deserves to be rejected. The facts in the above case are that an owner of a large area of land which he had leased out in favour of two persons and for a certain period of time both lessees had appointed a common Manager for cultivation of land. The question which fell for consideration was whether in the facts of that case, two owners could be assessed as an association of individuals. The Manager of the lessees was acting as their agent. In contrast, in the instant case, the Assessee – Society manufactures salt and markets the same in furtherance of the decisions taken by the Board of Management of the Society. Therefore, this

judgment does not support the case of the Assessee in any manner.

2. *B.T.Manjappa Gowda and others v. State of Karnataka (Through Commissioner of Agricultural Income-tax) reported in (1984) 150 ITR 303:*

In the above case, this Court has recorded a specific finding which reads as follows:

“There is absolutely no indication to hold that they had formed themselves into an association of individuals for promotion of a joint enterprise to earn income, profits or gains.”

It is to be noted that, in the above case, the family properties of an H.U.F. consisting of Manjappa Gowda, his wife and five children out of whom four were minors were divided by metes and bounds and being managed by Manjappa Gowda himself. In the facts of the said case, this Court has recorded a finding in the following terms:

“There is no evidence that all the members including the four minors formed a unit to earn income, profits or gains. There is also no

evidence that those minors represented by their guardians have given their assent to put their share of properties in the joint enterprise.”

Therefore, the ratio of the above case is also not applicable to the facts of this case.

3. *Commissioner of Income Tax vs. Manjunatha Motor Service and Canara Public Conveyances reported in 1992(197) ITR 321:*

In this case, two companies namely, Manjunatha Motor Service and Canara Public Conveyance were operating buses in a particular route under an agreement and sharing the profits. The Assessing Authority considered the same as a joint venture. However, the Appellate Authority upheld the contention of the Assessee that the two limited companies had already been assessed in respect of their share of profit for the assessment year under consideration and accordingly, allowed the appeal in favour of the Assessee.

In contrast, in the instant case, for the assessment year 2007-08 the Society has transferred a sum of

Rs.1,56,71,462.51 to the Distributable Pool Fund Account and filed a return showing Rs.1,20,170/- as carried forward loss and computed the income as NIL. There is no material on record placed by the Assessee either before the Assessing Authority, the Appellate Authority or before this Court which would demonstrate that the sum of Rs.1,56,71,462.51 which was transferred to Distributable Pool Fund Account for distribution among the members of the Society was offered to tax. Therefore, the ratio of the said judgment cannot be made applicable to the facts of this case.

4. *Tuticorin Alkali Chemicals & Fertilizers Ltd. Vs. Commissioner of Income Tax, reported in (1997) 227 ITR 172:*

Learned Counsel for the assessee has relied upon following two sentences in the said judgment to substantiate his argument:

“it is difficult to follow this reasoning. If a person borrows money for business purposes but utilises that money to earn interest, however

temporarily, the interest so generated will be his income. This income can be utilised by the Assessee in whichever way he likes.”

However, the learned standing Counsel for the appellant quickly pointed out that the above judgment supports the case of the Revenue with regard to the accounting practice. He placed reliance on the following observation of the Apex Court in the very case:

“It is true that this Court has very often referred to accounting practice for ascertainment of profit made by a company or value of assets of the company. But when the question is whether the receipt of money is taxable or not or whether, certain deductions from that receipt are permissible in law or not, the question has to be decided according to principles of law and not in accordance with the accounting practice.”

17. A careful analysis of the rival contentions urged by the Revenue, the Assessee and perusal of records, leads us to infer and deduce that;

- a) that no person other than a ‘Malik’ can be a member of the Assessee- Society;

- b) a 'Malik' is a person owning jointly or severally or having an interest in 'Agar' (land on which salt is manufactured);
- c) Society has taken the 'Malik' rights from its owners;
- d) Society is managed by a Managing Committee;
- e) Society manufactures salt and other by-products and sells the same in its own name; Therefore, the income earned is the income of Society and therefore liable to tax;
- f) The amount distributable among the members is transferred to a Distributable Pool Fund Account before offering the income to tax.

18. 'Income' is defined under Section 2(24) of the Act and it includes profits and gains. The above facts lead us an irresistible inference that the 'Agar' (the land) belonging to the 'Maliks' is used to manufacture salt and its by-product and the same is sold by the Assessee-Society itself. In the course of its business, Society earns 'profits'

which falls within the definition of 'income' under Section 2(24) of the Act. Therefore, in our considered view, the Assessing Authority was right in holding that the transfer of fund for subsequent distribution to the members before payment of tax is not a '*deductible expenditure*' in computation of business income of the Assessee-Co-operative Society and further that the income declared after disbursement of profits is not logical and has no relevance to determination of taxable profit under the Income Tax Act.

19. Revenue collection augments State exchequer.

A prosperous treasury is a means for development leading to good living of citizenry. Income Tax one of the tributaries which flows into State coffers. Therefore, we are of the view it is imperative for the Courts to opt strict interpretation while dealing with fiscal laws.

20. Based on evidence and admission of appellant, we have held, that the Society has transferred funds to Distribution Pool before offering to Tax. On facts, we have held that, the Society has indulged in the enterprise of

manufacture and sale of salt. Non compliance of statutory provisions is sought to be justified by the Society on a plea that Society indulges in such enterprise on behalf of members of the society and tax demand on the entire income would run counter to cooperative movement.

21. There can be perhaps no disagreement with the proposition that Co-operative movement is benevolent to its members. Nonetheless, an ideology however lofty does not *ipso facto* exempt such entity from the solemn duty and sacrosanct obligation of obeying the law of the land nor does it insulate the entity from the vigour of penal actions in case of default. Thus, assessee a co-operative entity which runs a business enterprise is duty bound to offer its profits to tax before diverting any funds to the Distributable Pool Fund Account.

22. In the result, this appeal merits consideration and it is accordingly *allowed*. The substantial question of law raised by the Revenue is answered in it's favour. The impugned order in I.T.A.No.252/PNJ/2014 dated 23.1.2015 passed by the ITAT, Panaji Bench is set aside.

Consequently, the order passed by the Assessing Authority stands restored.

No costs.

**Sd/-
JUDGE**

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JUDGE**

Yn/cp*/vnp.

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