

Commissioner of Income-Tax, Lucknow v. Bazpur Co-operative Sugar Factory Ltd.

Civil Appeals Nos. 1358–1361 of 1979

[1989] 2 SCR 840 | 1989-05-01

Whether the member balances in the Loss Equalisation and Capital Redemption Reserve Fund were capital borrowed for business, permitting deduction under section 36(1)(iii) of the interest credited to members.

36(1)(iii) | 37 (alternative claim not decided)

Two-judge bench | R.S. Pathak, C.J. | L.M. Sharma, J.

Assessment years: 1968-69, 1969-70, 1970-71, 1971-72, 1972-73

Particular member fund is not borrowed capital; section 37 and state-law issues remain open

The section 36(1)(iii) holding concerns this fund's share-capital/reserve purposes and uncertain residual repayment, not every cooperative member deposit. Section 37 entitlement and its procedural availability were left open; the separate U.P. section 57 issue was not considered. This is the 1 May 1989 interest case, not the 1988 receipt case. The original prints conflicting AY 1968-69 figures of Rs 1,81,716 and Rs 1,18,716; four appeals cover five stated AYs without an individual allocation. Comprehensive later treatment and current-law/2025 mapping remain unverified.

01 FACTS OF THE CASE

The assessee, a cooperative society running a sugar mill, allotted partly paid shares to farmer members and established a Loss Equalisation and Capital Redemption Reserve Fund under Bye-law No. 50.

Producer-shareholders were required to contribute by reference to sugarcane supplied. The amended bye-law reproduced in the judgment provided for making partly paid shares fully paid and refunding the remaining balance after the existing institutional loan had been repaid. The fund was used in the business, including conversion of partly paid shares. On 8 September 1967 the directors resolved to pay 6% interest on members' remaining balances (physical page 3/SCR 842).

For AY 1968-69 the report gives inconsistent claimed-interest figures, Rs 1,81,716 and Rs 1,18,716, on the same page; neither is silently preferred. For AYs 1969-70 to 1972-73 it records Rs 1,34,609 for each year. The ITO disallowed the interest because the balances were member contributions, not business borrowings. The AAC affirmed, also questioning the directors' authority to pay interest under the bye-law. The Tribunal allowed the deduction, reasoning that business use of the deposits sufficed and an initial interest stipulation was unnecessary. It also rejected an objection under section 57 of the U.P. Co-operative Societies Act, 1965. The Allahabad High Court answered the referred questions for the assessee; Revenue appealed (physical pages 3–6/SCR 842–845).

Source: See the proposition-specific paragraph and PDF-page references below.

02 DISCUSSION BY THE HON'BLE COURT

Section 36(1)(iii), as applied in these assessment years, allowed interest paid on capital borrowed for the purposes of business or profession. The Court treated a genuine borrower-lender relationship as indispensable. Ordinary commercial meaning, rather than a strained extension to all debts or all deposits used in business, controlled. Its discussion of the cited authorities included the distinction that a loan creates a debt but a debt need not arise from a loan; the earlier 1922 Act and English cases were supporting authorities, not the operative enactments for these appeals (physical pages 6–8/SCR 845–847).

On this fund's actual terms and purpose, the contributions were not loans by the members. The Court understood them as making the shares fully paid, then defraying the institutional loan, with only a residual balance refundable. There was no certainty of a balance remaining, and no intention to create a borrower-lender relationship. It also considered the original bye-law's contemplated use for the institutional loan, Government share, losses and conversion into member share capital. Use of the money in the business and the later resolution to pay interest did not turn those contributions into borrowed capital (physical pages 8–9/SCR 847–848).

The parties expressly confined argument to the first two income-tax questions and asked the Court not to consider the third question concerning section 57 of the U.P. statute. When the assessee advanced an alternative section 37 claim, the Court said the necessary facts were not all before it. It expressly left open whether that alternative could still be raised before the Tribunal when the case returned for disposal in conformity with its opinion. There was neither a section 37 allowance nor a definitive procedural bar (physical pages 6 and 9/SCR 845 and 848).

Source: See the proposition-specific paragraph and PDF-page references below.

03 JUDICIAL DECISION

The Court allowed Revenue's appeals, set aside the High Court judgment in all the cases and answered the first two referred questions in the negative, for Revenue and against the assessee. Interest on these fund balances was not deductible under section 36(1)(iii). There was no order as to costs. The third state-law question was not considered, and both the merits and procedural availability of the alternative section 37 claim remained undecided (physical page 9/SCR 848).

Source: See the proposition-specific paragraph and PDF-page references below.

04 OUTCOME / IN WHOSE FAVOUR

In whose favour: Revenue on the section 36(1)(iii) questions

Appeals allowed; High Court judgment set aside; first and second referred questions answered in the negative; no order as to costs

Reasoned merits determination that the particular member contributions were not borrowed capital

No adjudication of section 57 of the U.P. Co-operative Societies Act; no ruling allowing or barring the alternative section 37 claim; no universal disallowance of interest on every cooperative member deposit.

Source: See the proposition-specific paragraph and PDF-page references below.

05 AKHB REVIEW POINT

Examine the real legal and commercial character of the funding before considering interest deduction. A member balance, a debt, business use and an interest credit do not by themselves establish borrowed capital. Here the contributions served share-capital and reserve purposes, and repayment of a residual balance was uncertain under the scheme. The analysis does not prohibit a cooperative society from having genuine member loans with materially different obligations.

Keep the reserved issues separate: the Court did not decide the state-law payment objection and did not decide the alternative section 37 claim or whether it remained procedurally available. This 1 May 1989 interest-deduction judgment is distinct from the same assessee's 6 May 1988 receipt-character case. The report's two conflicting AY 1968-69 figures and the four-appeal/five-assessment-year presentation should not be silently regularised. No comprehensive later-treatment or present-law/2025 mapping is certified.

Source: See the proposition-specific paragraph and PDF-page references below.

PROPOSITION-SPECIFIC SOURCE PARAGRAPHS AND PDF PAGES

1.

Topic: Identity and full appeal group

Source url: [Open cited source](#)

Pdf pages: 1; 2

Paragraphs: Unnumbered judicial text; physical PDF pages one-based

Source role: reported metadata

2.

Topic: Fund, resolution, AYs and conflicting first-year amounts

Source url: [Open cited source](#)

Pdf pages: 3; 4

Paragraphs: Unnumbered judicial text; physical PDF pages one-based

Source role: judicial text

3.

Topic: Reference questions and state-law question expressly left aside

Source url: [Open cited source](#)

Pdf pages: 5; 6

Paragraphs: Unnumbered judicial text; physical PDF pages one-based

Source role: judicial text

4.

Topic: Borrowed-capital requirement and actual fund character

Source url: [Open cited source](#)

Pdf pages: 6; 7; 8; 9

Paragraphs: Unnumbered judicial text; physical PDF pages one-based

Source role: judicial text

5.

Topic: Alternative section 37 reservation, disposition and costs

Source url: [Open cited source](#)

Pdf pages: 9

Paragraphs: Unnumbered judicial text; physical PDF pages one-based

Source role: judicial text

JUDICIAL AUTHORSHIP AND SEPARATE OPINIONS

R.S. Pathak, C.J.

ACT IDENTIFIED IN THE REVIEWED SOURCE

Income-tax Act, 1961

SOURCE & VERIFICATION

[Hon'ble Supreme Court source PDF \(reported judgment\)](#)

Identified source rendition: 9 PDF pages; SHA-256

ab7869d48a2aaecd82042174f73b5339abfeec7be1c5ef4fa649c1846d1a1e34. Original bytes preserved.

Editorial headnotes and reported proceedings occupy physical pages 1–2/SCR 840–841. Complete Pathak C.J. judgment starts on physical page 3/SCR 842 and ends on page 9/SCR 848. Bye-law quotations, lower-authority findings and embedded precedent extracts distinguished. No neighbouring judgment.

[Open cited source rendition](#)

Physical page 3/SCR 842 prints the AY 1968-69 interest claim first as Rs 1,81,716 and later as Rs 1,18,716. Both readings are present in the image, not merely OCR noise; no corrected amount is asserted.; The reported docket on physical page 2 is Civil Appeals Nos. 1358–1361 of 1979, while the judicial account covers five AYs 1968-69 to 1972-73. No one-to-one allocation of years to appeals is supplied or invented.; The amended bye-law on physical page 3 names the Industrial Corporation of India; the reasoning on pages 4 and 8–9 identifies the Industrial Finance Corporation of India. The note uses institutional loan where necessary and attributes the Court's understanding of application of the fund.; Physical page 9 prints section 10(1)(iii) when describing Madhav Prasad Jatia; physical pages 7–8 and the substantive discussion concern the earlier section 10(2)(iii). The isolated internal-reference typo is not turned into a statutory holding.; Section 57 of the U.P. Co-operative Societies Act is a separate state-law issue, expressly not considered here. The Tribunal's opinion on it must not be labelled Supreme Court approval.; The section 37 plea failed to receive a merits determination because sufficient facts were absent; the Court expressly reserved whether the Tribunal could entertain it.

STATUTORY SCOPE

No automatic mapping to the Income-tax Act, 2025 or present-law certification. Apply the statutory text for the relevant year.

LATER TREATMENT

Source checked 2026-10-04. No comprehensive later-treatment search is certified. Any actually checked later judgment or statute is expressly identified in this note.

IDENTIFIED SOURCE LINKS

[reported judgment - PDF pages: 9](#)

SHA-256: ab7869d48a2aaecd82042174f73b5339abfeec7be1c5ef4fa649c1846d1a1e34

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