

PRINCIPLE OF MUTUALITY

[Its applicability to the income of social clubs and co-operative societies, etc.]

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There are a number of entities, the income / surplus of which is governed by the principle of mutuality and therefore, such income / surplus is not liable to income-tax. In other words, any surplus in the case of mutual concerns is exempt from income-tax and therefore, it would not form part of the gross total income of such mutual concerns.

The mutual concerns like social clubs and co-operative societies have various sources of income, some of which are governed by the principle of mutuality and hence not liable to income-tax, whereas others not so governed, are liable to income-tax.

What is a mutual concern?

A mutual concern or association is an association of persons (AOP), who agree to contribute funds for some common purpose mutually beneficial and receive back the surplus left out in the same capacity in which they have made the contributions. Therefore, the capacity as contributors and participants remains the same. The participation envisaged in the principle of mutuality is not that the members should take the surplus to themselves. It is enough if they have a right of disposal over the surplus – **CIT Vs. West Godavari District Rice Millers Association, 150 ITR p.394 (AP)**. It was further held in this case that the members contribute not with an idea to trade, but with an idea of rendering mutual help. The receipt in their hands is not really the profit, as no man can make a profit out of himself, just as he cannot enter into a trade or business with himself.

However, in every case in which it is claimed that any income or surplus is exempt from taxation on the ground that it is an income or surplus earned by a mutual concern, the Court has to scrutinize the facts and circumstances, whether three conditions have been satisfied. The assessee claiming an exemption of this nature must establish – (i) the identify of contributors and recipients, (ii) the instrumentality of the assessee in the matter of carrying out the mandates of its members, and (iii) the impossibility of the assessee deriving any profit from contribution made to it – **Indian Tea Planters’ Association Vs. CIT 82 ITR, p.322 (Cal.) and Cuttack Club (P) Ltd. Vs. CIT, 196 ITR p.407 (Ori.)**

In this context, we may refer to two land-mark judgements of the Supreme Court. The first judgement is in the case of **CIT Vs. Bankipur Club Ltd., 226 ITR p.97 (SC)**. It was held in this case that excess of receipts over expenditure received by club from facilities extended to its members as part of advantage attached to such membership, is not taxable as income. The second judgement is in the case of **Chelmsford Club Vs. CIT, 243 ITR p.89 (SC)**. It was held in this case that (i) income of a mutual concern is not assessable to tax, (ii) the charge of tax is on income from property and not on the property itself, and (iii) the income from property of a mutual concern is not assessable to tax.

There are a number of issues relating to the principle of mutuality and its applicability to the taxation of social clubs and co-operative societies etc. The same are dealt with hereinafter:

1. Principle of mutuality

The basic principle underlying the principle of mutuality is that no one can make profit out of himself. – **CIT Vs. Royal Western India Turf Club Ltd., 24 ITR p.551 (SC)**. In other words, no one can enter into a trade or business with himself. The essence of mutuality is complete identity between contributors and participators. – **CIT Vs. Kumbakonam Mutual Benefit Fund Ltd., 53 ITR p.241 (SC)**. In this case, the Supreme Court has laid down that the essence of mutuality lies in the return of what one has contributed to a common fund, and if profits are distributed as shareholders, the principle of mutuality is not satisfied. In this case, Supreme Court has also laid down that all participators must be contributors to the common fund; mere entitlement to contribute will not suffice.

There are mutual benefit funds or societies in respect of the income of which the principle of mutuality is normally claimed to be applicable. An entity governed by the principle of mutuality is ordinarily called a mutual concern. A mutual association or concern is an association of persons, who agree to contribute funds for some mutually beneficial common purpose and receive back the surplus left out in the same capacity in which they have made the contribution. Therefore, the capacity as contributors and participators remains the same. They contribute not with an idea to trade but with an idea of rendering mutual help. The receipt in their hands is not really a profit as no man can make the profit out of himself, just as he cannot enter into a trade or business with himself. – **CIT Vs. West Godavari District Rice Millers Association, 150 ITR p.394 (AP)**.

Recently, the Apex Court has settled the issues regarding the principle of mutuality in two land-mark judgements, viz. (i) **CIT Vs. Bankipur Club Ltd., 226 ITR p.97 (SC)**, and (ii) **Chelmsford Club Vs. CIT, 243 ITR p.89 (SC)**. The Supreme Court in the case of **CIT Vs. Bankipur Club Ltd., 226 ITR p.97** had an occasion to deal with the claims of a number of clubs seeking benefit based on the principle of mutuality. The principle laid down by the Apex Court in the case of Bankipur Club Ltd., may be summarised, as follows:

“Under the Income-Tax Act, what is taxed is, the ‘income, profits or gains’ earned or ‘arising’, ‘accruing’ to a ‘person’. 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 in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associating together in this way does not give rise to profits, which are chargeable to tax. Where the trade or activity is mutual, the fact that, as regards certain activities, certain members only of the association take advantage of the facilities which it offers, does not affect the mutuality of the enterprise.” [Head Note p.97 of the Report]

In this case, there were four appeals, the assesseees being **Bankipur Club Ltd., Ranchi Club Ltd., Cricket Club of India** and **Northern India Motion Pictures Association**. The main issue in all these

appeals was, whether the assessee-mutual clubs, were entitled to exemption for the receipts or surplus arising from the sales of drinks, refreshments, etc. or amounts received by way of rent for letting out the buildings or amounts received by way of admission fees, periodical subscriptions and receipts of similar nature from its members. In all these cases, the Tribunal as also the High Court had found that the amounts received by the clubs were for supply of drinks, refreshments or other goods as also the letting out of building for rent or by way of admission fees, periodical subscription, etc. from the members of the clubs and the same were only for/towards charges for the privileges, conveniences and amenities provided to the members, which they were entitled to, as per the rules and regulations of the respective clubs. It had also been found that different clubs realised various sums on the above counts only to afford to their members, the usual privileges, advantages, conveniences and accommodation. In other words, the services offered on the above counts were not with any profit motive, and were not tainted with commerciality. The facilities were offered only as a matter of convenience for the use of the members (and their friends, if any, availing of the facilities occasionally).

In view of the aforesaid facts, the Supreme Court held, dismissing the appeals, that in the light of the findings of fact the receipts for the various facilities extended by the clubs to its members, as part of the usual privileges, advantages and conveniences, attached to the membership of the club, could not be said to be from “a trading activity”. The surplus-excess of receipts over the expenditure – as a result of mutual arrangement, could not be said to be “income” for the purpose of the Act.

The principle of mutuality in respect of the income of “mutual concern” has been further clarified by the Apex Court in the case of **Chelmsford Club Vs. CIT, 243 ITR p.89 (SC)**. The principles laid down have been summarised in the head note on pp.89 & 90, which is reproduced, as follows:

“Under the Income-Tax Act, what is taxed is, the ‘income, profits or gains’ earned or ‘arising’, ‘accruing’ to a ‘person’. 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 in any sense as profit. There must be complete identity between the contributors and the participators. If these requirements are fulfilled, it is immaterial what particular form the association takes. Trading between persons associating together in this way does not give rise to profits, which are chargeable to tax. Where the trade or activity is mutual, the fact that, as regards certain activities, certain members only of the association take advantage of the facilities, which it offers, does not affect the mutuality of the enterprise. The law recognises the principle of mutuality excluding the levy of income-tax from the income of such business to which the above principle is applicable. A perusal of S. 2(24) of the Income-tax Act, 1961, shows that the Act recognises the principle of mutuality and has excluded all businesses involving such principle from the purview of the Act, except those mentioned in clause (vii) of that section. The three conditions, the existence of which establishes the doctrine of mutuality are (i) the identify of the contributors to the fund and the recipients from the fund, (ii) the treatment of the company, though incorporated as a mere entity for the convenience of the members, in other words, as an instrument obedient to their

mandate, and (iii) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves.”

The assessee, a members’ club, provided recreational and refreshment facilities exclusively to its members and their guests. Its facilities were not available to non-members. The club was run on “no profit no loss” basis in that the members paid for all their expenses and were not entitled to any share in the profits. Surplus, if any, was used for maintenance and development of the club. The club house was owned by the assessee. The assessee claimed that it was a mutual concern and so the annual letting value of the club house was not assessable. The claim was rejected by the High Court.

On appeal to the Supreme Court, it was held, reversing the decision of the High Court, that the assessee’s business was governed by the doctrine of mutuality. It was an admitted fact that the business of the assessee did not come within the scope of business referred to S. 2(24)(vii). It was not only the surplus from the activities of the business of the club that was excluded from the levy of income-tax, even the annual value of the club house, as contemplated in S.22 of the Act, would be outside the purview of the levy of income-tax.

2. To what types of income of mutual concerns, the principle of mutuality is applicable?

The basic principle of mutuality applies to all non-commercial activities. As regards income from commercial pursuits, if a club or society or any other entity sets about on an adventure of a commercial nature, it would lose its identity as a mutual concern and it cannot lay any claim for exemption.

The mutual concerns like social clubs and co-operative societies have various sources of income, some of which are governed by the principle of mutuality and hence are not liable to income-tax, whereas others are not so governed and therefore, they are liable to income-tax.

It was held by Patna High Court in the case of **CIT Vs. Bankipur Club Ltd., 198 ITR p.261 (Pat. FB)** that income from letting out the rooms and halls to the members of the assessee club and their guests was not taxable. Similarly in the case of **CIT Vs. National Sports Club of India (No.1), 230 ITR p.777 (Delhi)**, it was held that the rent receipt from members to whom rooms were let out by the assessee-club, which was a mutual concern, along with other facilities, was not taxable as income. The aforesaid view has been affirmed by the Apex Court in the case of **Chelmsford Club Vs. CIT, 243 ITR p.89 (SC)**.

Based on the aforesaid principle of mutuality as laid down by the Apex Court, some of the illustrations of the applicability of the principle of mutuality, are given as follows:

(i) Sports Club of Gujarat Ltd. Vs. CIT, 171 ITR p.504 (Guj.)

It was held in this case that the principle of mutuality would govern the surplus that arose to the assessee-sports club, which would otherwise be assessable U/S 28 (iii) but not income from interest which was earned on fixed deposits with banks, made by the assessee.

(ii) CIT Vs. Apsara Co-operative Housing Society Ltd., 204 ITR p.662 (Cal.)

The assessee was a co-operative housing society. During the relevant year, the assessee received transfer fee for change of hands of flats. The Tribunal held that the persons became members first before they were entitled to get the flats transferred in their names or were liable to pay the transfer fees. There was an element of mutuality in respect of transfer fees and therefore, this receipt was not to be subjected to tax.

It was held that as the Tribunal found that there was no profit element in the transaction, the society, under its regulations or bye-laws, realises transfer fee from a member when the member intends to transfer the flat to any other person, member or otherwise and this amount was taken for the benefit of the members of the society and not for business purposes.

(iii) CIT Vs. Merchant Navy Club, 96 ITR p.261 (AP)

A members' club formed for social intercourse and for either recreation or for cultural activities, cannot be considered to trade for profit so as to make its surplus taxable in law when it over-charges its members for the supply of refreshments, beverages or amenities to its members; such supplies are not sales as there is no element of transfer of property in them.

(iv) CIT Vs. West Godavari District Rice Millers' Association, 150 ITR p.394 (AP)

It was held in this case that the subscriptions and donations received from the members of association of rice millers for construction of the building were not taxable since the doctrine of mutuality applied.

(v) Cawnpore Club Ltd. Vs. CIT, 183 ITR p.620 (All.)

The income of the assessee-club derived from letting out rooms to its members was held as exempt from tax on the principle of mutuality.

As already pointed out, the issue regarding the income from letting out of rooms stands settled by the judgement of the Apex Court in the case of **Chelmsford Club Vs. CIT, 243 ITR p.89 (SC)**. It was held in this case that income from property of a mutual concern is not assessable to income-tax.

(vi) CIT Vs. Delhi Gymkhana Club Ltd., 155 ITR p.373 (Delhi)

In this case, the assessee-club had a number of rooms and these were made available to members as well as non-members on payment of fixed monthly charge and such charge was not merely by way of room rent but also for the provision of various other facilities such as furniture, fixtures, hot and cold water facilities, maintenance of lawn, supply of electricity, room service, supply of linen, scavenging and sweeper facilities, watch and ward facilities and dining, bar and recreation facilities available in the club house.

It was held that receipts of the club were in the nature of payments made to the club for various kinds of facilities and services provided by it. The levy of a composite charge for such provision of facilities of residence and other incidentals could not be equated to the charging of a house rent or a

rent for occupation of a residential building. Accordingly, the assessee's receipts from the members were exempt on the ground of mutuality.

The same view was taken by the High Court in **CIT Vs. National Sports Club of India (No.1), 230 ITR P.777 (Del.)** and **CIT Vs. National Sports Club of India (No.2), 230 ITR p.780 (Del.)**

(vii) **CIT Vs. Trivandrum Club, 177 ITR p.550 (Ker.)**

In this case, though the rules and bye-laws of the assessee-club enabled it to allow non-members to enjoy the facilities of the club, during the relevant period, no non-member was allowed to occupy any room of the club. It was held that no trading element was involved when the club charged a member for the amenities provided to him and thus, the assessee was entitled to exemption under the doctrine of mutuality.

(viii) **CIT Vs. Bombay Oilseeds & Oil Exchange Ltd., 202 ITR pp.198, 206, 210 (Bom.)**

The judgement in this case, may be summarised, as follows:

The cardinal principle to apply the test of mutuality is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund. In other words, there must be complete identity between the contributors and the participators. The question whether all the members were contributors or not is a question of fact, which has to be decided in each case by the authorities concerned. In the facts of that case, the Tribunal was held justified in holding that the test of mutuality was satisfied with regard to laga receipts and the said receipts did not constitute income of the assessee.

(ix) **CIT Vs. Indian Paper Mills Association, 209 ITR p.28 (Cal.)**

In this case, the assessee was held to be a mutual concern and consequently the income derived by the assessee by way of subscription and admission fees was held not liable to be taxed.

(x) **CIT Vs. Adarsh Co-operative Housing Society Ltd., 213 ITR pp.677, 694 (Guj.)**

The judgement in this case, may be summarised, as follows:

In all matters, where the scope of 'mutuality' has to be considered, the particular case and the provisions of law as applicable should not be lost sight of. In the facts of that case, the assessee-society was regarded as a mutual body and, consequently, the amount received by the assessee from its members on allotment of lands by lease, as also 50% of the excess amount from its members on transfer of lands by such members, has been held not liable to be taxed as income of the assessee.

3. When a mutual concern can be said to indulge in trading activity

The decision of the Supreme Court in the case of **CIT Vs. Royal Western India Turf Club Ltd., 24 ITR p.551 (SC)** and **CIT Vs. Kumbakonam Mutual Benefit Fund Ltd., 53 ITR p.241 (SC)**; laid down the broad proposition that if the object of the assessee-company claiming to be a "mutual concern" or "club", is to carry on a particular business and money is realised both from the members and non-members for the same consideration by providing the same and similar facilities to all alike in respect of

the one and the same business carried on by it, the dealings as a whole, disclosed the same profit earning motive and are tainted with commerciality.

The Apex Court in the case of **CIT Vs. Bankipur Club Ltd., 226 ITR p.97 (SC)** has laid down certain guide lines in this respect, which have been summarised in the head-note on 97 & 98 of the Report and reproduced, as follows:

“The decisions of the Supreme Court in **CIT Vs. Royal Western India Turf Club Ltd., 24 ITR p.551; CIT Vs. Kumbakonam Mutual Benefit Fund Ltd., 53 ITR p.241** and **Fletcher** (on his own behalf and on behalf of **Trustees and Committee of Doctor’s Cave Bathing Club**) **Vs. ITC, 3 All ER 1185 (PC)**, lay down the broad proposition that, if the object of the assessee-company claiming to be a “mutual concern” or “club”, is to carry on a particular business and money is realised both from the members and from non-members, for the same consideration by giving the same and similar facilities to all alike in respect of the one and the same business carried on by it, the dealings as a whole, disclose the same profit-earning motive and are alike tainted with commerciality. In other words, the activity carried on by the assessee in such cases, claiming to be a “mutual concern” or “members’ club” is a trade or an adventure in the nature of trade and the transactions entered into with the members or non-members alike is a trade / business / transaction and the resultant surplus is profit-income liable to tax.”

On the basis of the aforesaid judgements, it may be stated that the activity carried on by the assessee in the aforesaid types of cases, claiming to be a “mutual concern” or “members’ club”, is a trade or an adventure in the nature of trade and the transactions entered into with the members or non-members alike is a trade or a business transaction and the resultant surplus is profit-income liable to tax.

Certain instances of non-mutual concerns

(i) **CIT Vs. Salem District Urban Bank Ltd., 8 ITR p.269 (Mad.)**

It was held in this case that a co-operative society, which carries on ordinary banking business with non-members also, is not a mutual benefit society.

(ii) **Automobile Association of Bengal Vs. CIT, 69 ITR p.878 (Cal.)**

It was held in this case that where the assessee, an automobile association which, running on no-profit basis, published a monthly magazine for the benefit of its members and collected advertisements for this purpose both from non-members and some of the members, the profits so made went to increase the funds of the assessee and benefits out of the same came to the members qua members but not qua contributors or advertisers and thus, there was absence of mutuality and this made the profit, the income of the assessee-association and taxable as such.

(iii) **CIT Vs. Madras Race Club, 105 ITR p.433 (Mad.)**

In this case, where the assessee-club had as its primary business the running of race clubs and the members who paid subscriptions were admitted free on race days and the club also provided allied facilities to its members like golf, billiards, tennis, etc.

It was held that the primary purpose of the subscription was to get facilities to attend the races, the enjoyment of the club facilities on non-race days being only incidental or subsidiary, this was not a case where there was a contribution of monies by certain persons coming together for trading or non-trading purposes without any idea of making a profit. This was not also a case of mere members' club, which came into existence for the purpose of providing certain amenities to the members without any business element as such. Therefore, the claim for exemption could not be said to have been established either on the principle of mutuality or on the principle of the absence of trade or profit motive.

(iv) **Rajpath Club Ltd. Vs. CIT, 211 ITR p.379 (Guj.)**

In this case, the interest received by the assessee, a sports club, from Fixed Deposit in bank has been held taxable, as the interest was not from a mutual activity.

4. Interest on Fixed Deposits is liable to tax

Interest on fixed deposits in a bank is taxable as income. It was held in the case of **Rajpath Club Ltd. Vs. CIT, 211 ITR, p.379 (Guj.)** that interest received by the assessee, a sports club, from fixed deposit, was taxable, as the interest was not from mutual activity. Similarly it was held in the case of **CIT Vs. Salem District Urban Bank Ltd., 8 ITR p.269 (Mad)**, that a co-operative society carrying on banking business with non-members also, was not a mutual benefit society.

5. In case of multi-activity the income governed by the principle of mutuality will remain exempt from tax:

It was held in the case of **CIT Vs. Ranchi Club Ltd., 196 ITR p.137 (Pat.-FB)** that merely because the assessee company had entered into transactions with non-members and earned profits out of such transactions, its right to claim exemption on the principle of mutuality in respect of transactions conducted by it with its members, is not lost.

The aforesaid view has also been supported in the following cases:

(i) **CIT Vs. Delhi Gymkhana Club Ltd., 155 ITR p. 373 (Del.)**

In this case, the assessee-club had a number of rooms and these were made available to members as well as non-members on payment of a fixed monthly charge and such charge was not merely by way of room rent but also for the provision of various other facilities such as furniture, fixtures, hot and cold water facilities, maintenance of lawn, supply of electricity, room service, supply of linen, scavenging and sweeper facilities, watch and ward facilities and dining, bar and recreation facilities available in the club house.

It was held that the receipts of the club were in the nature of payments made to the club for various kinds of facilities and services provided by it. The levy of a composite charge for such provision of facilities of residence and other incidentals could not be equated to the charging of a house rent or a rent for occupation of a residential building. Accordingly, **the assessee's receipts from the members were exempt on the ground of mutuality.** (Emphasis supplied)

(ii) **National Mutual Life Association of Australasia Ltd. Vs. CIT, 5 ITC, p.238 (Bom.)**

In this case, where the assessee, a mutual life insurance company limited by guarantee, had no share capital and every participating policy-holder was deemed a member, it was held that any premiums paid by those entitled to participate in policies who become thereby the members of the company were not profits of the company. The company ought to have been charged upon its income derived from investments and on profits from non-participating policies or any other sources but not on the contributions from the participating policy-holders.

(iii) **Millowners Mutual Insurance Association Ltd. Vs. CIT, 6 ITC p.7 (Bom.)**

In this case the articles of association of the assessee, a mutual insurance company, constituted for insuring its members, provided for ascertainment of profits and their distribution among the members only but these profits were not distributed

It was held that the surplus of calls or premiums and further sums received by the company **from its members** over the expenditure of the year was not assessable as profits or gains of business.

6. Erosion of the concept of tax exemption on the basis of principle of mutuality.

The general principles regarding non-taxability of mutual income have been subjected to statutory erosion in view of the provisions of S.2(24)(vii) and S.28(iii).

Section 2(24) defines “income”. As per S. 2(24)(vii), the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society; are to be treated as part of income liable to tax under the Income-Tax Act, 1961. The computation of such income is to be computed in accordance with the provisions of S.44 of the Act or any surplus is to be taken as profits and gains by virtue of the provisions contained in the First Schedule to the Income-Tax Act.

Section 28 deals with the income chargeable under the head “profits and gains of business or profession”. Under S.28, various types of incomes are chargeable to income-tax under the head “profits and gains of business or profession”. Under S. 28(iii), income derived by a trade, professional or similar association from specific services performed for its members is chargeable to income-tax under the head “profits and gains of business or profession”. This clause makes an exception to the general rule that income of a mutual association is not subject to charge of income-tax. In order words, the concept behind S. 28(iii) is to cut at the mutuality principle being relied upon in support of a claim for exemption, when the assessee actually derives income for making profits as a result of rendering its specific services for its members in a commercial manner. This clause creates a statutory fiction - **CIT Vs. South Indian Film Chamber of Commerce, 129 ITR p.22 (Mad.)**. This clause applies to income derived by a trade, professional or similar association from the specific services performed for its members. A “Trade Association” is an “association of tradesmen, businessmen, or manufacturers for the protection and advancement of their interest”. Every trade, professional or similar association which renders its specific services to its own members for remuneration related to those services would come within the purview of S. 28(iii) – **Indian Tea Planters’ Association Vs. CIT, 82 ITR p.322 (Cal.)**.

The word “specific” only means definite, distinctly formulated or stated with precision. The expression “performing its specific services” in S. 28(iii), means “conferring particular benefit”, that is, conferring on the members some tangible benefits which would not be available to them unless they paid the specific fees charged for such benefits – **CIT Vs. Calcutta Stock Exchange Association Ltd., 36 ITR p.222 (SC).**

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