Transfer fees received by a co-operative housing society are exempt from income-tax under the principle of mutuality

188 CTR (ART.) P.284

[The judgement of the Special Bench of the ITAT, Mumbai, in the case of Walkeshwar Triveni Co-op. Hsg. Socty. Ltd., needs reconsideration]

- By S.K. Tyagi

Recently, the Special Bench of the ITAT, Mumbai, has rendered a judgement in the case of *Walkeshwar Triveni Co-op. Hsg. Society Ltd. Vs. ITO [2003] 80 TTJ 673 (Mumbai) (SB),* which has generated lot of controversy in the legal circles. This judgement has unsettled the well settled legal position in respect of the tax-treatment regarding the transfer fees received by a co-operative housing society.

In the aforesaid judgement, the ITAT has laid down-

(i) Transfer fees or premium received by a co-operative housing society from the outgoing member on transfer of the flat etc., upto the limit allowed by law viz. Rs.25,000/- per flat; is not liable to tax.

(ii) Transfer fees or premium received from the incoming member or the transferee is liable to tax.

(iii) Any amount received by the society from any member whether the transferor or the transferee on the sale of flat, beyond the limits prescribed in the bye-laws or the Government Notification, is liable to tax.

Besides, the ITAT has also observed that if a society charges transfer fees or premium more than what is prescribed under the law, stern action should be taken against such society. In this context, paras 76, 85 and 86 of the aforesaid order of Tribunal are very relevant. The same are reproduced as follows:-

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76. It transpires from the perusal of the aforesaid rule that the maximum amount of premium cannot exceed Rs.25,000. It is as per the norms set out by the Government. The society can raise fund only for achieving the objects of the society and not for any other purpose. So long the society is charging the amount of premium within the framework of law, no profit motive can be attributed to the society. However, if it is found that the society charged more than what is prescribed under the law, in that eventuality, of course stern action should be taken against the society.

85. Co-operative housing societies in our country are playing a very special and prominent role in catering to the housing needs of our people. If the society is a voluntary association, created for mutual help without

profit motive, no tax is being charged on the income of such society. This profile of taxation at times tempts the human ingenuity to defile the law. Consequently the spirit of mutuality is abused with impunity. To hoodwink the law premium is worded under different names, viz., donation, welfare fund, common amenities fund, etc. etc. Such contributions are compulsive to effect the transfer. Society can put interdict on the transfer de hors such contribution. As such, there is quid pro quo in accepting such contributions. Such charges are neither legal nor voluntary. Profit is the prime object for making such charges to effect the transfer. This amounts to malpractice. Such unlawful or illegal means should not be encouraged.

86. *Bacon said, "laws are like cobwebs; where the small flies are caught, and the great breakthrough". To maintain the majesty of law, it is imperative that innocent should not suffer and recalcitrant should not go scot-free. If a co-operative housing society indulged in malpractices and adopted unlawful or illegal means to achieve the objective, it should face the consequences. But if there is no evidence apropos any malpractice, it won't be fair to view the society with suspicion. If the premium is charged within the limits prescribed under law, no profit motive can be attributed to the society. It is just to ensure an income to the society which is to be utilized for the common good. However, if the excess amount is charged—be it a donation or payment under any other nomenclature—profit motive will pervade and mutuality will cease to exist. Ex-consequenti, the profit will be exigible to tax.*

The aforesaid judgement of the Special Bench of the ITAT suffers from a number of flaws

In my opinion, the aforesaid judgement of the Special Bench of the ITAT suffers from a number of flaws, some of which are as follows:-

(i) It has not taken into consideration a very relevant judgement of the Apex Court in the case of *Chelmsford Club Ltd. Vs. CIT [2000] 243 ITR 89 (SC).*

(ii) It has not taken into consideration another very relevant judgement of the Delhi High Court in the case of *DIT Vs. All India Oriental Bank of Commerce Welfare Society [2003]130 Taxman 575(Del.).*

(iii)It has not taken into consideration very relevant observations of another judgement of the Calcutta High Court in the case of *CIT Vs. Apsara Co-operative Housing Society Ltd.[1993] 204 ITR 662 (Cal.)*

The Special Bench of the ITAT has not considered the law as laid down in the aforesaid judgements.

According to the aforesaid judgements of the Supreme Court, Calcutta and Delhi High Courts, a co-operative housing society is a mutual concern and income of any mutual concern, except those covered under Section 2(24)(vii) of the IT Act, is outside the purview of the levy of income-tax.

The relevant parts of the aforesaid judgements are discussed as follows:-

(i) *Chelmsford Club Ltd. Vs. CIT [2000] 243 ITR 89 (SC).*

In this case the Apex Court has held that the activities of the assessee-club, being a mutual concern, were governed by the principle of mutuality and therefore, the surplus from the activity of providing recreational and refreshment facilities to the members, as also the income by way of annual value of the club house, as contemplated U/S 22 of the IT Act, would be outside the purview of the levy of income-tax. In this context, the following parts of the judgement on pp.95, 97 & 99 of the Report, are very relevant and the same are reproduced, as follows:

(a)**"***The law recognizes 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 Section 2(24) of the Income-tax Act, 1961, shows that the Act recognizes 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 (1) the identity of the contributors to the fund and the recipients from the fund, (2) 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 (3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves*.**"**

(b) ***For the reasons stated above, we are of the view that the business of the appellant is governed by the principle of mutuality even the deemed income from its property is governed by the said principle of mutuality. Therefore, these appeals have to succeed. Accordingly the appeals are allowed and the judgement impugned herein is set aside.***

The aforesaid judgement of the Apex Court, has clearly laid down that income of any mutual concern, except those covered under Section 2(24)(vii) of the Act, is outside the purview of the levy of income-tax. The Apex Court has gone to the extent of even holding that the income by way of

rent received from the club house was also governed by the principle of mutuality and hence exempt from income-tax. In the light of the aforesaid legal position, the receipts by way of contribution from the members of a co-operative housing society, whether incoming or outgoing, would be governed by the principle of mutuality and accordingly, fall outside the purview of the levy of income-tax.

(ii) *CIT Vs. Apsara Co-operative Housing Society Ltd.[1993] 204 ITR 662 (Cal.)*

The Calcutta High Court has laid down in the aforesaid judgement that a co-operative society, particularly a co-operative housing society, is a mutual concern.

The relevant observations of the High Court on pp. 664, 665 and 666 of the Report, are reproduced as follows:-

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(a) **"***The question of assessability in terms of Section 2(24)(vii) only arises if the co-operative society is engaged in business. In this case, it is a housing co-operative society and it does not carry on business. It only provides, residential apartments to the members of the society.***"**

(b) **"***This principle, in our view, is applicable to a mutual concern and shall apply in the case of a co-operative society. It is the members who form themselves into a co-operative society for the purpose of having a co-operative housing society and there was no question of any profit element in such an association or in having a transfer fee. The Tribunal has not found that there was any profit element involved. It is a mutual concern*."

(c) **"***We are of the view that the aforesaid principles applicable to the members' club will equally apply to the facts of a co-operative society, particularly of a housing co-operative society which does not carry on any business and where no element of profit is involved.***"**

(iii)*DIT Vs. All India Oriental Bank of Commerce Welfare Society [2003]130 Taxman 575(Del.).*

In this case, it was held that the assessee was a mutual concern and in view of the decision of the Apex Court in the case of *Chelmsford Club Vs. CIT* [2000] 243 ITR 89 (SC), the **interest income** derived by the assessee co-operative society on deposits made out of contributions from members of the society, was not taxable in the hands of the society. The relevant part of the judgement on p 577 of the Report is reproduced, as follows:

"*The issue with regard to the concept and principle of mutuality had been elaborately examined by the Apex Court in Chelmsford Club Vs. CIT [2000] 243 ITR 89 Their Lordships have held that 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 generated cannot in any sense be regarded as profits chargeable to *tax. It has been observed that what is required to be seen is whether there is a complete identify between the contributors and participators. Once the identify of the contributor to the fund of the recipients of the funds; the treatment of the company, though incorporated as a mere entity for the convenience of the members, in other words as an instrument obtained to their mandate; and the impossibility that the contributors should derive profits from contributions made by themselves, is established, the doctrine of mutuality is established.***"**

The aforesaid judgement has reiterated the conditions for an entity to be a mutual concern, as laid down by the Apex Court in the case of *Chemlsford Club* (*supra*). In this context, it may be submitted that a member of co-operative society before the finalisation of the sale deed of his flat, is very much a member thereof and therefore, any contribution made by him towards the upkeep and maintenance of the society building, cannot be treated as income liable to income-tax and hence not liable to tax in the hands of the co-operative society.

From the aforesaid judgements, it is quite clear that a co-operative housing society is a mutual concern and income of any mutual concern except in cases covered under Section 2(24)(vii) of the IT Act, is outside the purview of the levy of income-tax.

Here it would be necessary to refer to the definition of income as provided under Section 2(24). In this context, it would be appropriate to reproduce Section 2(24) (vii) of the IT Act. Therefore, the same is reproduced as follows:-

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S.2(*24*)"income" includes—

(i) …….

(ii) …….

…

(vii) the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with Section 44 or any surplus taken to be such profits and gains by virtue of provisions contained in the First Schedule ;

…

(xii) …….

As already explained, the Supreme Court has clearly laid down in the case of *Chelmsford Club Ltd. Vs. CIT [2000] 243 ITR 89 (SC)*, that income of any mutual concern, except in cases covered under the aforesaid S.2(24)(vii) of the IT Act, is outside the purview of the levy of income tax. The mutual concerns covered under aforesaid S.2(24)(vii)of the IT Act, refer to the business of insurance carried on by a mutual insurance company or by a co-operative society. Therefore, it is abundantly clear that any income of a co-operative housing society is outside the purview of the levy of income-tax.

In view of the aforesaid reasons, the judgement of the Special Bench, as aforesaid, does not represent the correct legal position and therefore, the same requires to be reconsidered.

As already explained that the judgement of the Special Bench of the ITAT in the aforesaid case suffers from major / fatal flaws, as the relevant judgements of the Apex Court and High Courts have not been considered therein.

The Special Bench has very elaborately discussed the concept of mutuality, vis-à-vis co-operative housing society, vide its observations in paras 60-70 on pp.689 to 692 of the Report. In the aforesaid paras, the ITAT has accepted the fact that co-operative housing societies are governed by the principle of mutuality. In para 81, on p.694 of the Report, the ITAT states – '*no one can make profit out of himself. In short this is the principle of mutuality. The cardinal requirement is all the contributors to the common fund are entitled to participate in the surplus, etc.'*

The ITAT has, however, gone off-tangent while restricting the exemption to Rs.25,000/-, which is not,at all, relevant, once we accept that under the principle of mutuality, the income of a co-operative housing society is not taxable. As far as the restriction of Rs.25,000/- is concerned, it is a part of the model bye-laws and a co-operative housing society may always change its bye-laws. It may be stated here that if the members wish to have their own bye-laws, they may get the same duly registered with the Registrar of Co-Operative Societies and in such bye-laws the society may charge transfer fees exceeding Rs.25,000/-.

Another flaw in the aforesaid judgement is that the transfer fees received from the incoming member have been held to be be liable to tax.

In view of the judgement of the Apex Court in the case of *CIT Vs. Bankipur Club Ltd. [1997] 226 ITR 97 (S.C.),* the transfer fees received from the incoming members of the society will also be tax-free, as the entrance fee received by the Club from new members is held to be tax-free. Besides, the society gets a right to retain transfer fees only after the incoming member is admitted as its member and therefore, there is no logic in the aforesaid view taken by the I.T.A.T. On the other hand, the case for exemption of contribution / transfer fees received from an incoming member is much stronger than that of an outgoing member, because the incoming member would be there to enjoy the benefit of the aforesaid contribution / transfer fees, after the transfer of the flat, etc.

In view of the aforesaid reasons, the judgement of the ITAT, Special Bench, Mumbai, in the case of *Walkeshwar Triveni Co-operative Housing Society Ltd*., requires to be re-considered.

S. K. TYAGI
M.Sc., LL.B., **Advocate**
Ex-Indian Revenue Service
Income-Tax Advisor

☎ Office : (020) 2613 3012
Fax : (020) 2612 1131
Residence : (020) 2668 2032
: (020) 2668 2444
E-mail : sktyagidt@vsnl.com

Flat No.2, (First Floor)
Gurudatta Avenue
Popular Heights Road
Koregaon Park
PUNE - 411 001