Commissioner Of Income-Tax, Bier vs M/S. Bankipur Club Ltd on 8 May, 1997

Equivalent citations: AIR 1997 SUPREME COURT 2312, 1997 (5) SCC 394, 1997 AIR SCW 2197, 1997 TAX. L. R. 634, (1997) 5 JT 191 (SC), 1997 (2) UPTC 1071, 1997 (5) COM LJ 113 SC, 1997 (4) SCALE 146, 1997 KERLJ(TAX) 345, (1997) 5 COMLJ 113, 1997 UPTC 2 1071, (1997) 92 TAXMAN 278, (1997) 226 ITR 97, (1997) 43 KANTLJ(TRIB) 279, (1997) 5 SUPREME 208, (1997) 4 SCALE 146, (1997) 138 TAXATION 720, (1997) 140 CURTAXREP 102, (1997) 2 BANKCAS 344, (1998) 109 STC 427

Bench: K. S. Paripoornan, S. Saghir Ahmad

PETITIONER:
COMMISSIONER OF INCOME-TAX, BIER

Vs.

RESPONDENT:
M/S. BANKIPUR CLUB LTD.

DATE OF JUDGMENT: 08/05/1997

BENCH:
K. S. PARIPOORNAN, S. SAGHIR AHMAD

ACT:

HEADNOTE:

JUDGMENT:

WITH CA NOS. 505/92, * SLP(C) 22644/94, CA 3974/92, 4777-78/89, 4534/91, 1635/94, 1648-1649/94, 2380-82/94- SLP (C) 2811/94, CA 8046/95, 1773/92, 4303/95, 3840/96 AND 10194/95. * CA 3382/97 ** CA 3383/97 Present:

Hon'ble Mr. Justice K.S. Paripoornan Hon'ble Mr. Justice S. Saghir Ahmad J. Ramamurthy, Harish N. Salve, Sr. Advs, S. Rajappa, Dhruv Mehta, B. Krishna Prasad, P. Parmeswaran, D.S. Mehra, U. Rana, Rajiv Tyagi, Sudhanshu Tripathi,

M.J.S. Rupal, P. Mukherjee, Sanjoy Kumar Ghosh, (Manoj Swarup) Adv. for M/s. Manoj Swarup & Co., S.K. Aggrawal, Vinay Vaish and Amarendra Sharan, Advs. with therm for the appearing parties.

J U D G M E N T The following Judgment of the Court was delivered. PARIPOORNAN, J.

Special leave granted in SLP (C) Nos. 22644/94 and 2811/94.

2. This batch of 23 cases was posted together. That was so done on the basis that the same and identical point arises for consideration in all of them. On further verification, it turned out that in 7 appeals, the point that arises for consideration is little different. On the question arising in those appeals no arguments were advanced. So, the said seven appeals are de-linked, to be posted later for hearing.

3. For convenience sake, the 23 cases including seven appeals which are de-linked can be classified into 5 groups. Group-A: C.A. Nos. 854-858/86 Commissioner of Income-tax * Bihar v. M/s. Bankipur Club Ltd. Group-B: C.A. Nos. 505/92 and 3974/92 - Commissioner of Income-tax. Bihar-II v. Ranchi Club Ltd., Group-C: C.A. No. 5382./97 (arising out of SLP (C) No.22644/94 and C.A. No.10194/95 - Commissioner of Income tax Bombay v. Cricket Club of India; Group-D: C.A. Nos. 1635/94 * 1648-49/94, 2380-82/94 and C.A. No. 3583/97 (arising out of SLP (C) No. 2811/94) - Commissioner of Income tax Jalandhar v. Northern India Motion Pictures Association, Group-E: C.A. Nos. 4777-78/89, 4534/91, 8046/95, 1773 (NT)/92, 4303/95 and 3840/96 - Commissioner of Income tax, Kanpur v. Cawnpore Club Ltd.

4. As state earlier, the appeals coming within Group - E - CIT, kanpur V. Cawnpore Club Ltd. (seven appeals) are de- linked and they will be posted separately to be heard on merits. We shall indicate the reason for this a little later.

5. We heard counsel. The following vital aspects should be borne in mind in adjudicating the question that arises for consideration in this batch of 16 appeals (covered by Groups A to D). The Revenue is the appellant in all the appeals. The respondents in all the appeals are "Members' Clubs". They are also called "social action groups". They are all companies, registered under Section 25 of the Companies Act, 1956 - "non-profit companies". The respondents are assessees to income tax. They claimed exemption on their "surplus receipts" on the ground that they are "clubs" - a species of mutual undertaking, and do not carry on any "trade or business". They do not earn any profit. The income received by the clubs by extending facilities to non-members is not in issue in this batch of appeals. According to Revenue, even the surplus receipts of the clubs by affording facilities to its members, is "income" and so, taxable. That is the sole question arising for consideration in this batch of appeals.

6. Under the Income-tax Act (hereinafter referred to as 'the Act') what is taxed is, the "income, profits or gains earned or "arising", "accruing' to a person". The question is whether in the case of Members' Clubs - a species of mutual undertaking - in rendering various services to its members

which result in a surplus, the club can be said to "have earned income ar profits" In order to answer the question, it is necessary to have a background of the law relating to "Mutual trading" or "Mutual undertaking" and a "Members' Club".

7. In Halsbury Laws of England, 4th Edition Reissue Volume 23 paras 161 and 162 (pages 130 and 132), the relevant law is stated thus:

> "Where a number of persons combine together and contribute to a common fund for the financing of some venture or object and will 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. xxx xxx xxs Members clubs are an example of a mutual undertaking, but, where a club extends facilities to non-members, to that extent the element of mutuality is wanting..... "
>
> (Emphasis supplied) Simon's Taxes Vol.B 3rd Edition, paragraphs B 1.218 and B1.222 (pages 159 and 167), formulate the law on the point, thus:
>
> "..... it is settled law that if the persons carrying on a trade do so in such a way that they and the customers are the same persons, no profits or gains are yielded by the trade for tax purposes and therefore no assessment in respect of the trade can be made. Any surplus resulting from this form of trading represents only the extent to which the contribution of the participators have proved to be in excess of requirements. Such a surplus is regarded as their own money and returnable to them. In order that this exempting element of mutuality should exist it is essential that the profits should be capable of coming back at some time and in some form to the persons to whom the goods were sold or the services rendered. ....."
>
> "lt has been held that a company conducting a members' (and not a proprietary) club, the members of the company and of the club being identical, was not carrying on a trade or business or undertaking of a similar character for purposes of the former corporation profits tax.
>
> A members' club is assessable, however, in respect of profits derived from affording its facilities to non-members. Thus, in Carlisle and Silloth Golf Club v. Smith [1913(3) K. B. 75], where members' golf club admitted non members to play on payment of

> green fees it was held that it was carrying on a business which could be isolated and defined and the profit of which was assessable to income tax. But there is no liability in respect of profits made from members who avail themselves of the facilities provided for members."

(emphasis supplied) In British Tax Encyclopedia (I) 1962 edition (edited by G.S.A. Wheatcroft) at pages 1200 and 1201, dealing with "Mutual trading operations", the law is stated, thus:-

> "In several early cases there were dicta to the effect that a man could not make a profit be trading with himself this developed into the proposition that when persons contribute to a common fund in pursuance of a scheme for their mutual benefit, having no dealings or relations with any outside body, they cannot be said to have made a profit when they find they have overcharged themselves and that some portion to their contributions incorporate themselves into a separate entity to carry out the mutual scheme and the surplus contributions are put to reserve and not immediately returned. For this doctrine to apply it is essential that all the contributors to the common fund are entitled to participate in the surplus and that all the participators in the surplus are contributors so that there is complete identity between contributors and participators. This means identity as a classs so that at any given moment of time the persons who are contributing are identical with the persons entitled to participate; it does not matter that the class may be diminished by persons going out of the scheme or increased by other coming in. .. ..
>
> The doctrine now has application in three areas. First, it applies to mutual insurance companies; secondly, it applies to certain municipal undertakings and, thirdly, to members' clubs, and mutual associations generally, whether incorporated or unincorporated, except registered industrial and provident societies. ... ..."

(emphasis supplied) It should be noticed that in the case of "mutual society or concern" (including a "Members' club"), there must be complete identity between the class of contributors and the class of participators. The particular label or form by which the mutual association is known, is of no consequence. The said principle which has been laid down in the leading decisions and emphasised in the leading English text books mentioned above, has been explained with reference to Indian decision in "The Law and Practice of Income Tax" (8th edition vol. 1, 1990) by Kanga & Palkhivala at page 113, thus:-

> "..... The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid. The Madras. Andhra Pradesh and Kerala High Courts have held that the test of mutuality does not require that the contributors to the common fund should willy-nilly distribute the surplus amongst themselves: it is enough if they have a right of disposal over this surplus, and in exercise of that right they may agree that on winding up the surplus will be transferred to a similar

> association or used for some charitable objects "

8. The crucial issue that arises for consideration in cases where it is claimed that on the basis of the principle of mutuality, the receipts by the "society" or "club" is exempt from taxation, has been succinctly stated by the judicial Committee of the Privy Council in Fletcher v. Income Tax Commissioner [1971 (3) AJI ER 1185 at page 1189], thus:

> "... ... ... Is the activity, on the one hand, a trades or an adventure in the nature of trade producing a profit, or is it, on the other, a mutual arrangement which, at most, gives rise to a surplus?"

In substance, the arrangement or relationship between the club and its members should be of a non-trading character.

9. In C.A. Nos. 854-858184 (Group-A), the assessee is M/s. Bankipur Club Ltd.. The appeals are preferred against the common judgment of the Patna High Court rendered in T.C. No.46-50/70 dated 14.10.1980 reported as Commissioner of Income-tax, Bihar v Bankipur Club Ltd. (129 ITR 787). The questions referred to the High Court are the following:

> "(i) Whether, on the facts and in the circumstances of the case the profits arising from the sales made to the regular members of the club is entitled to exemption on the doctrine of mutuality.
>
> (ii) Whether, on the facts and in the circumstances of the case the directions given by the Tribunal are valid in law?"

The assessment years involved are 1960-61 to 1964-65. The assessee club filed "nil" returns. The assessee had income from house property and also from business or professica. The receipt under the head "sale of drinks at the Bar" was alone disputed in all the aforesaid five years. The Income Tax Officer held that the profit on the sale proceeds of the drinks by the club in income and so, liable to be taxed. It is seen that the main object of the club, as per the memorandum of association, is to afford to its members all the usual privileges, advantages, conveniences and accommodation of a club. Clause 5 of the memorandum of association makes a provision that upon a winding-up or dissolution of the company if there remains any property left after the satisfaction of all debts and liabilities the same shall be paid to and distributed amongst the members of the company in equal shares. Article 6 of Articles of Association reads thus:

> "Only permanent members shall be deemed to be members of the club."

Article 15 speaks of temporary members who may be elected for non exceeding three months in any calendar year. To become a temporary member the person would be a person not permanently residing at Patna or within ten miles of it. No entrance fee is payable by them, but they are to pay a fixed monthly subscription. Under Article 5, the Governor and the Chief Minister of the State may be invited by the committee to become honorary members of the club. Article 17 is a provision for

giving to the temporary and the honorary members all the privileges of the club, subject to such restrictions and regulations as may be prescribed by the rules or bye-laws of the club. They have, however, no right to vote at a meeting or be elected on committees or bring any guest. The assessments were upheld by the Appellate tribunal accepted the plea of the assessee that the principle of mutuality would apply in regard to the sale of drinks at the bar. It was held that as regards sales to regular members the profit arising from sales to them is not liable to be taxed under the principle of mutuality. The High Court adverted to the fact that nobody is allowed to enjoy the privileges of the club other than its members and the bar in question where drinks are sold is open to its members, both permanent as well as temporary, and that no outsider can purchase any drink from the said club. The High Court took the view that while selling drinks to its members, it is not done with motive of profit earning which can be said to be tainted with "commerciality". The members pay the monthly subscription and in addition, they enjoy the benefit of this privilege of supply of drinks to them on additional payment and so there is no profit earning motive so far as this transaction is concerned. The Court concluded that the profits arising from the sales of drinks at the bar to the regular members of the club is entitled to exemption on the doctrine of "mutuality".

10. In C.A No. 505/92 and C.A No. 3974/92 (Group-B), the assessee is Ranchi Club Ltd. The main decision is one rendered in T.C. 54/80, subject matter of C.A. 505/92. The judgment is dated 24.9.1991 and is reported in Commissioner of Income-tax v. Ranchi Club Ltd. [196 ITR 137 (FB)]. The questions referred to the High Court are as follows:

> "(1) Whether on the facts and in the circumstances of the case. the Tribunal has rightly held that the assessee-club is a mutual concern?
>
> (ii) Whether, on the facts and in the circumstances of the case, the Tribunal has rightly held that the income derived by the assessee-

club from its house property let to its members and their guests is not chargeable to tax?

(iii) Whether, on the facts and in the circumstances of the case, the Tribunal has rightly held that the income derived by the assessee-club from sale of liquor, etc, to its members and their guests is not taxable in its hands"

> In these cases, the assessee was a company formed with the main object of providing a club house and other conveniences for the use of its members and their friends. The memorandum of association provided for contribution has the members to the common fund of the club, guarantee towards debts and liabilities, and upon winding up, their participation in the surplus. Apart from the concept of "member" envisaged a in the memorandum, it had created one more class described as temporary members. The temporary members were not deemed to be members. For the assessment year 1977-78. the assessee had filed its return showing its income under the head property" representing the income arising out of gross rent and reservation charges received by it from persons other than members. But, the Income-tax officer, while assessing the income, also the Income-tax Officer, while assessing the income,

also included the amount received by the assessee even from its members on account of rent from the club property and the receipts on sale of liquor, etc, to its members and their guests. The decision rendered by the High Court as summarised in the head-note (196 ITR 137 at page 139) is as follows:-

".. .. that merely because the assessee company had entered into transactions with non-members and earned profits out of transactions held with them, its right to claim exemption on the principle of mutuality in respect transactions held by it with its members was not lost. The assessee was a mutual concern. The income derived by it from its house property let to its members and their guests and from the sale of liquor etc.. to its members and their guests was not taxable in its hands."

(emphasis supplied)

11. C.A. No. 10194/95 and C.A. No...../97 (arising, out of SLP (C) 22644/94) relate to the assessee, the Cricket Club of India. The proceedings relate to Assessment years 1977-78 and 1978-79. Amongst others, the Cricket Club of India was in receipt of income from property owned by it - chambers in the building of the assessee let out to members, annual value of the club house and annual value of Patiala Pavilion. The above facilities were provided only to members of the association and that too temporary accommodation. The arrangement was essentially for the benefit of the members. Following the decision rendered by the Appellate Tribunals Bombay Bench, for the assessment years 1974-75 and 1976-77 rendered in ITA Nos. 1730 and 1913 (Bombay) of 1980 the appellate tribunal held that no portion of the Club House. Patiala Pavillion etc. is let out to strangers and that these portions are let out only to the members and so, even if an income had actually accrued due from the members on the above counts, it will not be taxable on the principles of mutuality. In the application filed under Section 256(2) of the Act, the High Court declined to refer the question of law posed by the Revenue, to the effect, "whether the appellate tribunal was justified in law in holding that the income from the property held by the assessee could not be brought to charge under the provisions of Sections 22 to 26 of the Act?" The decision was followed for the assessment year 1978-79 - C.A. 10194/95 and the High Court declined to refer any question of law for this year as well. In fact both the years. the decision of the appellate tribunal to the effect that the income received from the aforesaid counts is exempt under the principle of mutuality, was not doubted by the High Court? holding that no referable question of law arose by its decision.

12.We now come to Group-D In C.A. Nos. 1635/94. 1648-49/94, 2380-82/94 and C A 3383/97 @ SLP 2811/94) come within this group. The assessee in this case is Northern India Motion Pictures Association. The details with regard to the above appeals are as follows:

S. NO.	NO.	ASSESSMENT YEARS	REMARKS

1. CA No.1635 of 1987-88 Appln. U/S 1994 256(2) rejected

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2. CA Nos. 1648- 1982-83 & 1985- do 49 of 1994 86

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3. CA Nos. 2380- 1974-75 to 1976- Reference 82 of 1994 77 answered in favour of assessee

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4. SLP (C) No. 2811 1989-90 Appln. U/S. of 1994 256(2) rejected

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The assessee is an association consisting of Film Distributors and Exhibitors incorporated as a company under Section 25 of the Companies Act? 1956 (Section 26 of the Companies Act, 1913) in the year 1949 The income of the Association consists of (i) admission fees, readmission fees, periodical subscriptions from the members, etc. under the head "others" and (ii) service charges from the members for rendering specific services to the members under the head "Service to the members". The income under the head "Service to the members" was always offered for tax and assessed to tax under Section 28(iii) of the Act and there is no dispute about the same. The income under the head "others" was claimed to be not taxable on the principle of mutuality. The claim of the assessee for exemption from levy of tax, on the ground of "mutuality" was denied in view of clause 7 of the Memorandum of Association of the Assessee. which was to the following effect:-

> "If upon the winding up or dissolution of the Association there remains after the satisfaction of all its debts and liabilities any property whatsoever the same shall not be paid to or distributed amongst the members of the Association but shall be given or transferred to such other institution or institutions having objects similar to the objects of the Association to be determined by the members of the Association at or before the time of dissolution or in default thereof by the Prime Minister of East Punjab, and if and so far as effect cannot be given to the aforesaid provision then to some charitable object."

(emphasis supplied) In an earlier assessment year, 1977-78 an identical question relating to the same assessee arose before the High Court of Punjab & Haryana in ITR No. 69/81. The decision thereon dated 27.4.1989 is reported in Commissioner of Income-tax v. Northern India Motion Pictures Association [180 ITR 160]. The following questions were referred to the High Court:-

> "(1) Whether, on the facts and in the circumstances of the case. the principle of mutuality is applicable to the assessee's receipts under the head 'Others'?

(2) Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the receipts under the head 'Others' were neither income liable to be taxed under the head 'Business' nor under the head 'Other sources?

The facts in the said case and the decision by the High Court are neatly summarised in the head note of the reports at pages 160-161:-

"The, assessee was an association and its members were film distributors and exhibitor's.

The association protected the rights of, its members in return for admission fees and periodical subscription and also rendered specific services in return for separate charges. The Income-tax Officer wanted to subject the assessee to tax on the income derived from the admission fee, periodical a subscriptions and specific service charges received from the members. The assessee pleaded that the receipts were exempt from tax on the general principle of mutuality. The Income-

tax Officer did not agree with the plea on the grounds that in clause 7 of the memorandum of association it was provided that upon winding up or dissolution of the association, the remaining property, after the satisfaction of its debts and liabilities, shall not be paid or distributed amongst the members but shall be given or transferred to such other institution or institutions having similar objects to be determined by the members at or before the time of dissolution, or in default thereof by the Prime Minister of the East Punjab and if this could not be done, then, to some charitable object and hence the amount was not to go back to the members. The Tribunal however held that the income of the assessee was not taxable. On a reference:

Held, that the contributors by incorporating clause 7 did not deprive themselves of the control on the disposal of the surplus. Ultimately, they could agree to divide the surplus among themselves or to contribute the amount to a similar association or to a charitable trust. The assessee was a mutual benefit association and its income was not taxable."

The said judgment was followed subsequently in all matters arising under Sections 256(1) and 256(2) of the Act. So, for the assessment years which are subject matter of cases falling under Group-D stated herein above, the above decision reported it 180 ITR 160 was followed and the income received by the assessee under the head "Others" - admission fees readmission fee. periodical subscription from the members etc. were held to be exempt or non-taxable on the principle of mutuality.

13. The above four sets of cases falling in Groups A to D shall alone be covered by this Judgment. With regard to 7 cases/appeals falling in Group-E the Assessee is Cawnpore Club Ltd. It is seen that the income that was sought to be assessed in the case of assessee, was one derived from property let out and also Interest received from F.D.R., N.S.C. etc. In these cases the Court held that income should be assessed as one from other sources" and not income from property. It does not appeal that the larger plea that the income is totally exempt on the principle of mutuality, was

decided in favour of the assessee in the appeals filed by the Revenue the only question that may probably arise is whether income received from the property let out and interest by way of F.D.R's., N.S.C. etc. can be brought to tax under the head; income from property". Since the issue raised in this batch of seven cases, is not similar to or same as the one involved in the other cases coming under Groups A to D. we do not propose to deal either a with the facts or the decisions rendered be the authorities in this batch of cases (Group-E). All that we propose to do is to delink the cases coming under Group-E and direct them to be posted separately for hearing and disposal before an appropriate Bench.

14. Now we turn to the main question canvassed be the Revenue in the appeals coming under Groups A to D, namely, whether the assessees, mutual clubs. are entitled to exemption for the receipts or surplus arising from the sales of drinks refreshments etc. or amounts received be 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 appellate tribunal as also the High Court have found that the amount received by the clubs were for supply of drinks? refreshments or other goods as also the letting out of building for rent or the amounts received be way of admission fees. periodical subscription etc. from the members of the clubs 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 has also been found that different clubs realised various sums on the above counts only to afford to its members the usual privileges, advantages, conveniences and accommodation. In other words, the services offered on the above counts were not done. 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 the light of the above findings, it necessarily follows that the receipts for the various facilities extended by the clubs to its members, as stated herein above as part of the usual privileges, advantages and conveniences; attached to the members of the club, cannot be said to be "a trading activity." The surplus - excess of receipts over the expenditure - as a result of mutual arrangement, cannot be said to be income" for the purpose of the Act.

15. Our attention was invited to a few decisions which have dealt with the subject matter in issue herein. The list of the various English decisions has been succinctly summarised in the textbooks which we have adverted to herein above (Halsbury's Laws of England, Simon's Taxes, Wheatcroft etc.). Particular stress was laid on the decisions of the Supreme Court in Commissioner of Income-tax. Bombay City v. The Royal Western India Turf Club Limited [24 ITR 551], Commissioner of Income-tax. Madras v. Kumbakonam Mutual Benefit Fund Ltd [53 1TR 241], Fletcher (on his own behalf and on behalf of Trustees and Committee of Doctor's Cave Bathing Club) v. lncome Tas Commissioner [1971 (3) All ER (PC) 1185]. We do not think it necessary to deal at length with the above decisions except to state the principle discernible from them. We understand

these decisions to 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 or 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 like a trade/business/transaction and the resultant surplus is certainly profit -- income liable, to tax. We should also state, that "at what point? does the relationship of mutuality end and that of trading begin" is a difficult and question. A host of factors may have to be considered to arrive at a conclusion. "Whether or not the persons dealing with each other, is a "mutual club"

> or carrying on a trading activity or an adventure in the nature of trade".is largely a question of fact. [Wilcock's case - 9 Tax Cases 111, (132) C.A. (1925) (1) KB 30 at 44 and 45.].

16. In the result, we hold that ht judgment and orders passed by the High Courts covered by Groups A,B,C And D, as stated above, do not merit any interference. The reasoning and conclusion of the High Courts in the judgments and orders impugned are in accord with the settled legal principles as laid down by Courts. The 16 appeals covered by Groups A to D filed by the Revenue are, therefore, dismissed with costs, including advocate's fees which we estimate at Rs. 5,000/- in each appeal.