Commissioner Of Income-Tax, Madras vs Kumbakonam Mutual Benefit Fund Ltd on 7 May, 1964

Equivalent citations: 1965 AIR 96, 1964 SCR (8) 204, AIR 1965 SUPREME COURT 96, 1964 53 ITR 241, 1964 2 SCJ 473, 1964 8 SCR 204, 1964 (1) SCWR 847, 1964 2 ITJ 229

Author: S.M. Sikri

Bench: S.M. Sikri, J.C. Shah

PETITIONER:
COMMISSIONER OF INCOME-TAX, MADRAS

Vs.

RESPONDENT:
KUMBAKONAM MUTUAL BENEFIT FUND LTD.

DATE OF JUDGMENT:
07/05/1964

BENCH:
SIKRI, S.M.
BENCH:
SIKRI, S.M.
SUBBARAO, K.
SHAH, J.C.

CITATION:
1965 AIR 96 1964 SCR (8) 204

ACT:
Mutual Benefit Society-company engaged in banking business restricted to members-Not every member made deposits or loans-Profits mainly earned from loans to members-All members entitled to dividends-Whether requirement of mutuality between contributors and participators satisfied-Therefor whether company exempt under s. 10(2)(iii), Income-tax Act, 1922.

HEADNOTE:
The assessee, Kumbakonam Mutual Benefit Fund, Ltd., carried on banking business which was restricted to its shareholders. In the course
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of its working, recurring monthly deposits were obtained from members for an agreed number of months at the end of which, an amount, which included interest, was returned to them. From the funds accumulated as a result of these deposits, loans were given to members and the interest from such loans constituted the assessee's main income. After the payment out of this income of interest on the deposits as also all the other expenses and out goings of management, etc., the balance was divided among the members pro rata according to their shareholdings. The shareholders who were thus entitled to participate in the profits need not have either made deposits or taken loans. Although it was contended on behalf of the assessee that it was exempt from assessment to tax as a Mutual Benefit Society under s. 10 of the Income-tax Act, 1922, on the principle in New York Life Assurance Co. v. Styles, 2 T.C. 460, which was followed in Board of Revenue v. Mylapore Hindu Permanent Fund Ltd., (1924) I.L.R. 47 Mad. 1, the Income-tax Officer assessed the entire profits of the assessee. It was held by him that the profits made by the fund belonged to the members as shareholders and not as borrowers from the fund or in the capacity of individuals who had in any way utilised the facilities afforded by the fund. The requirement of identity between contributors and participators as in Style's case was not satisfied.

The Appellate Assistant Commissioner and the Income-tax Appellate Tribunal, upon appeals made to them in turn, upheld the order of the Income-tax Officer; the Tribunal, however, referred to the High Court,inter alia, the questionwhether there were materials for the tribunal to hold that the assesseewas a banking concern, assessable under s. 10 and was not therefor eexempt.

The High Court in answering the question in the negative applied the test that both the right to contribute and the right to participate must be available to an identical body but it was not necessary that every member should contribute before he could be allowed to participate.

Held: (i) The test applied by the High Court was not sound. There was a clear distinction between a case where profit which a company made out of its shareholders as customers- even if it was limited to trading only with them- and distributed to them as shareholders, and the case where all that a company did was to collect money from its members and applied it for the benefit of those same people, not as shareholders, but as people who subscribed it. For the principle in Style's case to apply, it was essential that all contributors to the common fund must be entitled to participate in the surplus and all participators must be contributors to the common fund; and not only that all participators must be entitled to contribute.

Municipal Mutual Insurance Ltd. v. Hills, 16 T.C. 430, C.I.T. v. Royal Western Indian Turf Club Ltd., 1954 1 S.C.R. 289, Dibrugarh District Chit Ltd. v. C.I.T., Assam, 2 I.T.C.

521, Thomas v. Richard Evans & Co., 11 T.C. 790, The National Association of Local Govern-
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ment Officers v. Watkins, 18 T.C. 499 and Ismailia Grain Merchants Association V. C.I.T., A.I.R. 1958 Bom. 32, referred to:
The decision in the Board of Revenue v. The Mylapore Hindu Permanent Fund Ltd. (1924) I.L.R. 47 Mad. 1, could not have been rightly based on Style's case.
The Madura Hindu Permanent Fund Ltd. v. C.I.T., 6 I.T.C. 326, referred to.
The decisions in the Sivaganga Sri Meenakshi Swadeshi Saswatha Nidhi Ltd. v. C.I.T.. 8 I.T.C. 83 and Tanjore Permanent Fund v. C.I.T. 5 I.T.R. 160, were based on the decision in the Mylapore Hindu Permanent Fund Case but in none of these cases was the point debated as to what the position would be when shareholders participated in profits as shareholders and not as contributors.

JUDGMENT:

Civil Appellate Jurisdiction: Civil Appeals Nos. 637644 of 1963.

Appeals from the judgment and order dated October 20, 1960, of the Madras High Court in Case Referred No. 78 of 1956. K. N. Rajagopal Sastri and R. N. Sachthey, for the appellant.

R. Kesava Iyengar, M. S. K. Iyengar and Krishna Pillai, for the respondent.

May 7, 1964. The Judgment of the Court was delivered by SIKRI J.The respondent, the Kumbakonam Mutual Benefit Fund Ltd., hereinafter referred to as the assessee, is a company incorporated under the Indian Companies Act. 1882, limited by shares. Since 1938. the nominal capital of the assessee is Rs. 33,00,000 divided into shares of Re. 1 each. It carries on banking business restricted to its shareholders, i.e., the shareholders are entitled to participate in the various recurring deposit schemes of the assessee or to obtain loans on security. The statement of the case describes the working of the assessee thus:

> "Recurring deposits are obtained from members for fixed amounts to be contributed monthly by them for a fixed number of months as stipulated at the end of which a fixed amount is returned to them according to published tables. The amount so returned will cover the compound interest of the period. These recurring deposits constitute the main source of funds of the assessee for advancing loans. Such loans are restricted only to members who have, however, to offer substantial security, therefor, by way of either the paid up value of their recurring deposits, if any, or immovable properties within 'the Tanjore district.

> Out of the interest realised by the assessee on the loans which constitute its main income, interest on the recurring deposits aforesaid are paid as also all the other outgoings and expenses of management and the balance is divided among the members pro rata according to their shareholdings after making provision for reserves, etc., as required by the Memorandum of Articles aforesaid. The shareholders who are thus entitled to participate in the profits need not have either taken loans or have made recurring deposits."

The Income-Tax Officer assessed the entire profits for eight years from 1946-47 to 1953-54. In a detailed and closely reasoned order, dated February 29, 1952, which is part of the statement of the case, passed in respect of the assessment year 1947-48, the Income Tax Officer held that New York Life Assurance Company v. Styles(1) did not apply to the facts of this case. He distinguished Style's(1) case thus:

> "Whereas the New York Life Assurance Company paid to its members what it had saved, the assessee fund pays to its members what it has earned. A share-holder in the New York Life Assurance Company did not get back anything more than what he contributed, a share-holder of the Kumbakonam Mutual Benefit Fund does (1) 2 T.C. 460 on the other hand get more than what he con-

tributes. A fixed depositor gets back on maturity of the deposit not only the amount he deposited but also the interest thereon. A recurring depositor who pays, say a rupee each month for eighty-six months does not get back Rs. 86 only, or something less, but-Rs. 100, the balance of Rs. 14 representing the interest on his deposit. What is returned to him is not a mere refund and there is no question here, as in the case of the New York Life Assurance Company, of his contributing money for a common purpose and getting back that much of his contribution as is not required for the common purpose. From the point of view of the individual member, an investment in the assessee fund is just like any other lucrative investment and his primary object in investing his money with the fund is the income, which comes to him in the guise of interest or dividend."

Relying on Rowlatt, J.'s, observations in Thomas v. Richard Evans Co. Ltd.,(1) that 'it-does not come back to them as purchasers or customers; it comes back to them as share- holders upon their shares', the Income Tax Officer held that "the profits made by the fund belong to them as share-holders and not as borrowers from the fund or in the capacity of individuals who have in any way utilised the facilities afforded by the fund." He further held that "there should firstly be a common fund and then it must be proved that the contributors to this common fund and the participators in the surplus are one and the same. As far as I can see, there is no common fund in this case. The income of the assessee is derived from interest on loans lent to its members, interest on Government securities, rents from property, etc., and it is distributed to the members either in the shape of guaranteed interest or dividends or both. As far as the allegedly "mutual" transactions of the assessee are concerned, the contributors to the income of the company (1)II T.C. 790 are those members who have borrowed from the assessee and paid interest on their borrowings. If the requirement of the complete identity between contributors and participators were to be satisfied, then the above contributors should also be entitled to participate in the profits." He further pointed

out that a shareholder may not hold any deposit with the fund and may not utilise the borrowing facilities afforded by the fund but may be content to receive such dividend as is declared.

The Appellate Assistant Commissioner, on appeal, upheld the order of the Income Tax Officer. It was urged before him, inter alia, that the decision in the case of Board of Revenue Madras v. The Mylapore Hindu Permanent Fund Ltd.,(1) applied to the facts because the capital was also fluctuating in this case. He, however, held that it was not a case of fluctuating capital but only a steady increase of capital. He further held that a shareholder need not be a subscriber to the fixed or recurring deposits, and a share- holder may not participate in the interest earnings if no dividend is declared.

On further appeal, the Income Tax Appellate Tribunal held as follows:

> "The fund's claim that it is in reality a mutual benefit society is untenable. The cardinal requirement is that all the contributors to the common fund must be able to participate in the surplus and that all the participators in the surplus must be contributors to the common fund. In other words, complete identity between the contri- butors and the participators is essential. Firstly, there is no common fund. Secondly, the shareholders may or may not receive a dividend. But those shareholders who contribute to the recurring deposits of various duration receive guaranteed interest. The persons who contribute to the income of the company are those shareholders who borrow from the appellant and pay interest on their borrowings.
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> (1) [1924] I.L.R. 47 Mad. 1 51 S.C.-14 Out of the income so derived, the guaranteed interest to the shareholders who make monthly deposits, receive guaranteed interest but the shareholders who do not contribute monthly deposits may or may not receive any dividend.

Thus, the complete identity between contribu- tors and participators does not exist. The nature of the business of the appellant is that of ordinary banking though the business is restricted to its members or shareholders only. This restriction does not in the least take the income of the appellant out of the purview of the charging sections of the Act. In our opinion, the Income-tax authorities were right in treating the appellant as a banking concern."

The Appellate Tribunal, however, stated a consolidated case in respect of the assessment years, 1946-47 to 1953-54, and referred the following questions to the High Court:

> "(1) Whether there were materials for the Tribunal to hold that the assessee is a banking concern assessable under Section 10 for all the assessment years and not exempt. (2) If the answer to the above question is in the affirmative and against the assessee, whether the payments to the non-recognised provident fund by the assessee for the six years of assessment 1946-47 and 1948-49 to 1952-53 are allowable deductions under any provisions of the Act."

We are here only concerned with question No. 1. The 'High Court, for reasons which will be shortly stated, answered the question in the negative, and awarded costs Rs. 250. It further ordered the refund to the assessee of the institu- tion fee of Rs. 100 for each of the references "as part of the costs to which as successful assessee it will be entitled to."

The High Court, after a review of the cases cited before it, came to the conclusion that the assessee satisfied the con- ditions necessary for the applicability of Style's case(1). According to it, the facts that the benefits of the association (i) T.C. 460 are available only to members thereof and no non-member can participate in the benefits, and that the profits that arise from this mutual trading are the result of the interest collected from members who take advantage of the loans offered by the fund and also of the default interest paid by members who delay payment of recurring deposits, and that the 'profit' after payment of interest to depositors and after meeting the other expenses of administration of the fund are available for distribution among the entire body of the members, showed that there was complete mutuality. It had that "what is accordingly required is that both the right to contribute and the right to participate must be available to an identical body and it is not necessary that every member should contribute before he can be allowed to participate. That this test is also satisfied in the present case is beyond question." It is this test which is attacked as unsound by the learned counsel for the appellant.

The High Court certified the cases as being fit for appeal to this Court, under s. 66 (A) (2) of the Indian Income Tax Act, and the appeals are now before us for disposal. The question that arises in this case is whether the Style's(1) case covers the facts of this case. In other words, to use the language of Lord Macmillan in Municipal Mutual Insurance Limited v. Hills(1) has the cardinal requirement, namely, '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', been satisfied?

Most of the cases, both English and Indian, bearing on the point under discussion, were reviewed by this Court in Commissioner of Income Tax v. Royal Western Indian Turf Club Ltd.(1), and this relieves us of the task of reviewing all of them again. We however, shortly deal with those in which companies limited by shares were concerned for they stand on a slightly different footing from companies limited by guarantee.

(1) 2 T.C. 460 (2) 16 T.C. 430 (3)[1954] S.C.R. 289 Although the facts in the Royal Western Turf Club case were different, this Court laid down the following:

> "The, principle that no one can make a profit out of himself is true enough but may in its application easily lead to confusion. There is nothing per se to prevent a company from making a profit out of its own members. Thus a railway company which earns profits by carrying passengers may also make a profit by carrying its shareholders or a trading company may make a profit out of its trading with its members besides the profit it makes from the general public which deals with it but that profit belongs to the members as shareholders and does not come back to them as persons who had

> contributed them. Where a company collects money from the members and applies it for their benefit not as shareholders but as persons who ,out up the fund the company makes no profit. In such cases where there is identity in the character of those who contribute and of those who participate in the surplus, the fact of incorporation may be immaterial and the incorporated company may well be regarded as a mere instrument, a convenient agent for carrying out what the members might more laboriously do for themselves. But it cannot be said that incorporation which brings into being a legal entity separate from its constituent members is to be disregarded always and that the legal entity can never make a profit out of its own members."

In the Dibrugarh District Club Ltd. v. The Commissioner of Income Tax, Assam(1), which was noticed by this Court, the Calcutta High Court distinguishing Style's(2) case held that the fact of incorporation could be neglected on the facts of the case. In that club, out of the members of the club only 69 were shareholders and 220 were non-

(1) 2 I.T.C. 521 (2) T.C. 460 shareholders, while 74 out of 445 of the shares were held by non-members of the club, and the profits of the club were being distributed every year as dividend to shareholders. Rowlatt J., in our opinion, correctly points out that if profits are distributed to shareholders as shareholders, the principle of mutuality is not satisfied. In Thomas v. Richard Evans and Co.(1), at pp. 822-823, he observes thus:

> "But a company can make a profit out of its members as customers, although its range of customers is limited to its shareholders. If a railway company makes a profit by carring its hareholders, or if a trading company, by trading with the shareholders-even if it is limited to trading with them-makes a profit, that profit belongs to the shareholders, in a sense, but it belongs to them qua shareholders. It does not come back to them -as purchasers or customers. It comes back to them as shareholders, upon their shares. Where all that a company does is to collect money from a certain number of poeple it does not matter whether they are called members of the company, or partici- pating policy holders-and apply it for the benefit of those same people, not as shareholders in the company, but as the people who subscribed it, then, as I understand the New York case, there is no profit. If the people were to do the thing for themselves, there would be no profit, and the fact that they incorporate a legal entity to do it for them makes no difference. there is still no profit. This is not because the entity of the company is to be disregarded, it is because there is no profit, the money being simply collected from those people and handed back to them, not in the character of shareholders, but in the character of those who have paid it. That, as I understand it, is the effect of the decision in the New York ease."

(1) I. T.C. 790 It seems to us that the test applied by the High Court is not sound. It is not consistent with the true decision in Style's case, as understood by this Court and in other subsequent cases. It will be noticed that Lord Macmillan clearly said that all participators must be contributors to the common fund and not that all participators must be entitled to contribute. The essence of mutuality

lies in the return of what one has contributed to a common fund. Das, J., as he then was, in the passage quoted above, in Commissioner of Income Tax v. Royal Western Indian Turf Club Ltd.(1) reiterated the same idea.

The learned counsel for the assessee, relying on The National Association of Local Government Officers v. Watkins(1), urged that it is not necessary that all must contribute to the common fund. But in that case it was an unincorporated association, and Finlay, J., regarded that as a matter of fundamental importance, for it followed from it, as held by Finlay, J., "that the property belongs to the members and it is a fallacy, as bad been pointed out in several cases, one at least of which was cited to me, to say in the case of such a club that, where a member orders a dinner and consumes it, there is any sale to him. There is not a sale. The fundamental thing is that the whole property is vested in the members." He emphasized this again when he says that "it may be that where you have a separate entity, where you have a company, in a great many cases the test is that you have to look at the subscribers, look at the participants, and see if they are the same. Here it seems to me to lie at the root of the thing that the property was not the property of the Association; it was the property of the members themselves.. ....." It is this feature of the case which Chagla, C.J., failed to notice in Ismailia Grain Merchants Association v. Commissioner of Income Tax(3).

We may now deal with the cases decided by the Madras High Court, and relied on by the learned counsel for the assessee. In Board of Revenue v. The Mylapore Hindu (1) [1954] S.C.R. 289 (2) 18 T.C- 499 (3) A.I.R. 1958 Bom. 32 Permanent Fund Ltd., (1) the Fund was registered under the Indian Companies Act of 1866. A shareholder subscribed one rupee per share per mensem and at the end of 7 years drew Rs. 102-8-0, and then he ceased to be shareholder (qua the share). A shareholder had to pay interest on the subscription, if not paid within the time prescribed by the rules. Apart from the interest on the subscription, the Fund derived income from interest on loans given exclusively to its members, every one of them being entitled under the rules to take loan, and occasionally from interest from outside investments with bank. The High Court held the Style's(2) case applied and also held that the income earned by the Fund by way of interest from its own members was not taxable under the Income Tax Act, 1918, in spite of the fact that such profits were devided among directors and distributed among the shareholders with reference to the number of shares and the number of months during which they had held them. But the point urged by Mr. Rajagopal Sastri was not raised before the High Court and the High Court was content to apply. the test 'whether the income comes in from outside and not from within'. But as held by the Full Bench in The Madura Hindu Permanent Fund Ltd. v. The Commissioner of Income Tax (3 this case could not have been rightly based on Style's case.

In The Sivaganga Shri Meenakshi Swadeshi Saswatha Nidhi Ltd. v. The Commissioner of Income Tax (4) the High Court, without adverting to doubts expressed in the decision in Madura Hindu Permanent Fund Ltd., (3) regarding the applicability of Style's case, which was referred to in thestatement of the case, and without giving any reasons,, heldthat the Mylapore Hindu Permanent Trust(1) case applied. In Tanjore Permanent Fund v. Commissioner of Income Tax(5) the High Court held that there was no conflict between the decision in Mylapore Hindu Permanent Fund(1) case and the Madura Hindu Permanent Fund(1) case. A&. (1) [1924] I. L.R. 47 Mad. 1 (2) 2 T.C. 460 (3) A I.T.C 326 (4) 8 I.T.C.. 83 (5) 5 I.T.R. 160 the facts in the case were similar to that in Mylapore

Hindu Permanent Fund (1) case, the High Court refused to reopen the question and disturb the practice, but however added that "though the term 'shareholder' has been here used, we do not wish to be understood as deciding that these subscribers are shareholders properly so called within the meaning of the Companies Act." As already pointed out, in none of these cases the point was debated as to what is the position when shareholders participate in profits as shareholders and not as contributors.

It seems to us that it is difficult to hold that Style's case applies to the facts of the case. A shareholder in the assessee company is entitled to participate in the profits without contributing to the funds of the company by taking loans. He is entitled to receive his dividend as long as he holds a share. He has not to fulfil any other condition. His position is in no way different from a shareholder in a banking company, limited by shares. Indeed, the position ,of the assessee is no different from an ordinary bank except that it lends money to and receives deposits from its shareholders. This does not by itself make its income any the less income from business within s. 10 of the Indian Income Tax Act.

In our opinion, the answer to the question referred to the High Court should be in the affirmative. 'Me appeals are accordingly accepted, but in view of the fact that the Mylapore Fund(1) case has held the field in Madras since 1923, we do not wish to burden the assessee with costs. Accordingly, the parties will bear their own costs through- ,out.

A subsidiary point was raised by Mr. Sastri that the High Court had no jurisdiction to order the refund of the reference fees deposited by the assessee. This is true. But the High Courts can, if they so deem fit in a particular case, assess the costs in such a way as to include the sum of Rs. 100 deposited as reference fee.

Appeal allowed.

(1) [1924] I.L.R. 47 Mad. 1 (2) 2 T.C. 460