M/S. Chelmsford Club vs Commissioner Of Income-Tax, Delhi on 2 March, 2000

Equivalent citations: AIR 2000 SUPREME COURT 1092, 2000 (3) SCC 214, 2000 AIR SCW 781, 2000 TAX. L. R. 375, (2000) 2 JT 580 (SC), 2000 (3) SRJ 424, (2000) 109 TAXMAN 215, (2000) 159 CURTAXREP 235, (2000) 2 SCALE 201, (2000) 2 SUPREME 111, (2000) 84 DLT 540, (2000) 156 TAXATION 644, (2000) 243 ITR 89

Bench: D.P.Wadhwa, N.S.Hegde

PETITIONER:
M/S. CHELMSFORD CLUB

Vs.

RESPONDENT:
COMMISSIONER OF INCOME-TAX, DELHI

DATE OF JUDGMENT: 02/03/2000

BENCH:
D.P.Wadhwa, N.S.Hegde

JUDGMENT:

SANTOSH HEGDE, J.

The following two questions were referred to the High Court of Delhi by the Income Tax Appellate Tribunal (for short the tribunal) in respect of assessment years 1977-78 and 1978- 79 :

> 1. Whether on the facts and in the circumstances of the case, the Honble Tribunal was legally correct in holding that the annual letting value of the Club building is not assessable to income-tax under the head Income from property ?
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> 2. Whether on the facts and in the circumstances of the case, the Honble Tribunal was legally correct in holding that the principle of mutuality applies to the property income and accordingly it is not taxable income of the assessee ?

The High Court relying on Section 22 of the Income Tax Act, 1961 (hereinafter referred to as the Act) and following the judgment of Allahabad High Court in the case of C.I.T., U.P. v. Wheeler Club Limited {(1963) 49 ITR 52} and some observations of the Delhi High Court in the case of C.I.T.,

Delhi-II v. Delhi Gymkhana Club Ltd. (155 ITR 373) answered the question in the negative and in favour of the Department. Against the said judgment of the High Court dated 11.11.1992, the appellant has preferred these appeals.

On behalf of the appellant, it is contended before us that the appellant though registered as a Company under the Companies Act, its business is governed by the principle of mutuality, therefore, the income, if any, earned by the appellant is outside the scope of the Income-tax Act. This is based on a principle that it is the only income which comes within the definition of Section 2(24) of the Act, that could be taxed and this definition generally excludes the income from business involving doctrine of mutuality, except the business that is included specifically in sub-clause (vii) of that Section. The appellant contends that its business admittedly does not come under that clause, hence, any income earned by the appellant is not exigible to income-tax. The appellant relies on a decision of this Court in C.I.T. vs. Bankipur Club Limited (226 ITR

97). It is further contended by the appellant that what is taxed under Section 22 of the Act is in reality an income, though in a deemed form and, therefore, this income is also outside the scope of income-tax in view of the principle of mutuality. For this proposition, the appellant relies on another judgment of this Court in the case of Bhagwan Dass Jain vs. Union of India & Ors. (128 ITR 315). On the contrary on behalf of the Revenue, it is contended that the business of the appellant is not governed by principle of mutuality because the said business does not show that there is any identity between the contributors and the participators as is required for establishing the doctrine of mutuality. For this proposition, the respondent relies on a judgment of this Court in the case of C.I.T., Bombay City vs. The Royal Western India Turf Club Ltd. (RWITC) (21 ITR 31). The respondent also contends that the levy of tax under Section 22 of the Act is a tax on property and not on income, therefore, the principle of mutuality does not apply to such levy. For this argument, the respondent relies upon a judgment of the Allahabad High Court in the case of C.I.T. vs. Wheeler Club Ltd. (supra).

Before we proceed to examine the rival contentions addressed before us, we should notice the undisputed facts necessary for disposal of these appeals which are as follows :-

> The appellant provides recreational and refreshment facilities exclusively to its members and their guests. Its facilities are not available to non-members. The Club is run on no profit no loss basis in that the members pay for all their expenses and are not entitled to any share in the profits. Surplus, if any, is used for maintenance and development of the Club. The Club house which is the subject-matter of these appeals is owned by the appellant and is used for providing facilities to its members. In the above factual matrix we will now examine the questions involved in these appeals.
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> We will first decide the question : whether under Section 22 of the Act, tax levied is on income from property concerned or on the property itself ? Obviously, this argument of the Revenue that the tax under Section 22 is being levied not on the income from the property but on the property is on the basis of the judgment of the Allahabad High Court in Wheeler Clubs case (supra) wherein a Division Bench of that

court held with reference to the business of a Club as follows:-

> liability to pay income tax arises from the mere fact of his owning the property having an annual letting value and not from his actually deriving any income from it. Even if he does not derive any income from it, as, for example, when he occupies it himself or lets it remain vacant, he is liable to pay tax.
>
> Section 9 does not exempt any income from a house except income from a house occupied for carrying on a business or profession. The assessee is not carrying on any business or profession in the quarters; therefore, the income from them is not exempted by anything contained in section 9. There is no provision and there is no law which exempts from assessment income from house property on the sole ground that the contributor of the income and the recipient are one and the same person. On the other hand, the fact that under the law an owner is liable to pay income-tax on the annual letting value even if he himself occupies the house, shows that the principle of mutuality does not apply in a case governed by section 9. Naturally, when the basis for assessing tax on income from property is the mere ownership of the property and not the actual realisation of income, the question whether the payer and the recipient are one and the same person cannot arise. It is only when what is assessed is income from business that the principle of mutuality may be applicable; where the basis for assessment is the earning of income, the question may arise whether the recipient of the income and the payer are not one and the same person.
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> It is to be noticed that this judgment was delivered under the provisions of the Income-tax Act, 1922 and Section 9 of that Act is similar to Section 22 of the present Act.

A perusal of the above judgment shows that the High Court in that case proceeded on the basis that the liability to pay income-tax under Section 9 arises from the mere fact of the assessee owning the property having an annual letting value and not from his deriving any income from it. It also held that the principle of mutuality does not apply to such measure of taxation. We find it difficult to agree with the High Court on this point. In our opinion, the High Court erred in coming to the conclusion that the tax levied under Section 9 of the Act (Section 22 of the new Act) is a tax on property, for more than one reason. Under the Act; be it the 1922 Act or the 1961 Act, the same does not permit the levy of tax on anything other than the income. It is so held by the courts in India. As far back as in the year 1946, the Bombay High Court in D.M. Vakil v. C.I.T. (14 ITR 298) held :

> It is true that under the Indian Income-tax Act the only thing that can be taxed is income and nothing else. The charging section is Section 3; it charges the total income of an assessee; and total income is defined in Section 2(15) as the total amount of income, profits and gains computed in the manner laid down in this Act. Though the above judgment was also delivered considering the provisions of the 1922 Act, in our opinion, the legal position remains to be the same under the 1961 Act also. Even if we examine this position independent of the High Courts decision referred to

> above, we find that the legislative competence to levy income-tax is traceable to Entry 82 of List I of Schedule VII to the Constitution which reads : Taxes on income other than agricultural income. Therefore, any law made under this Legislative Entry can impose a tax only on income and not under any other head, there is also no dispute that the Income Tax Act of 1961 is a law made under this Entry. Hence, it is futile to contend that the levy of tax under Section 22 of the Act is a tax levied on property and not on income from property. This view of ours further finds support from a reading of Section 4 of the Act which is the charging Section. This Section unequivocally shows that the levy is on income. A conjoint reading of Sections 2(24), 14, 22 and 23 of the Act also makes it abundantly clear that what is being taxed under Section 22 is the deemed income of an assessee from the property owned by him. At any rate, this question is no more res integra in view of the judgment of this Court in Bhagwan Dass Jain (supra) where this Court had an occasion to deal with this question where the levy of tax on income from house property came to be challenged on the ground of want of legislative competence, negativing the contention raised therein and rejecting the challenge, the Court held that what is being taxed under Section 22 of the Act is, in fact, an income and not the property. This Court after elaborately considering the decisions of various courts, came to the following conclusion : Even in its ordinary economic sense, the expression income includes not merely what is received or what comes in by exploiting the use of a property but also what one saves by using it oneself. That which can be converted into income can be reasonably regarded as giving rise to income. The tax levied under the Act is on the income (though computed in an artificial way) from house property in the above sense and not on house property. Entry 49 of List II of the Seventh Schedule to the Constitution is not, therefore, attracted. The levy in question squarely falls under entry 82 of List I of the Seventh Schedule to the Constitution.

The above case, in our opinion, squarely answers the arguments advanced on behalf of the Revenue. Therefore, the judgment of the Allahabad High Court in the case of Wheeler Club (supra) with regard to the nature of levy under Section 22 is not a good law.

Having come to the conclusion that Section 22 of the Act taxes only the income from property, we will now examine whether such income so far as the appellant is concerned, is not exigible to tax on the ground that such income is excluded from the purview of tax, based on the principle of mutuality. The appellant contends that its business is governed by the principle of mutuality which, in turn, is based on a doctrine that no person can earn from himself. It is the contention of the appellant that in the business undertaken by it, every member pays for his own expenses and there is no profit motivation or sharing of profits as such amongst the members. The surplus, if any, from the business is not shared by the members but is used for providing better facilities to the members. The appellant further contends that all the factors necessary for establishing the principle of mutuality in its business is seen from the admitted facts pertaining to its business. It is argued that unlike in the case of RWITC, in the business of the appellant, no outsider is allowed to take part and the facilities provided by the appellant is exclusively for its members and their guests. Therefore, there is a clear identity between the contributors and the participators to the fund and the recipients

thereof respectively. Per contra, based on the decision of this Court in the case of RWITC (supra), the Revenue contends that for the doctrine of mutuality to be applicable, there should be a clear identity between the contributors and the participators to the fund and the recipients thereof respectively, which, according to the Revenue, is lacking in the case of the appellant. A perusal of Section 2(24) shows that the Act recognises 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. It is also an admitted fact that the business of the appellant does not come within the scope of business referred to in Section 2(24)(vii). This Court in the case of RWITC (supra) on facts came to the conclusion that the Club in that case had kept open its business not only to its members but also to outsiders who would participate in the Clubs business on payment which income from the outsiders would go to the same kitty as that of the members, consequently, the identity between the contributors and the recipients was lost. Therefore, this Court held that the doctrine of mutuality did not apply in the case of RWITC (supra), otherwise this Court in that judgment had accepted that, in regard to the businesses governed by the doctrine of mutuality, the levy of tax under the Income-tax Act did not arise. This is clear from the observations of this Court in that judgment which are as follows:- It is clear to us, taking the facts admitted or found in the case before us, that the principles of Styles case, as explained by subsequent decisions noted above, can have no application to this case. Here there is no mutual dealing between the members inter se in the nature of mutual insurance, no contribution to a common fund put up for payment of liabilities undertaken by each contributor to the other contributors and no refund of surplus to the contributors. There being no mutual dealing the question as to the complete identity of the contributors and the participators need not be raised or considered. Suffice it to say that in the absence, as there is in the present case, of any dealing between the members inter se in the nature of mutual insurance the principles laid down in Styles case and the cases that followed it can have no application here. 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 its members and applies it for their benefit not as shareholders but as persons who put 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. What kinds of business other than mutual insurance may claim exemption from tax liability under Section 10(1) of the Act under the principles of Styles case need not be here considered; it is clear to us that those principles cannot apply to an incorporated company which carries on the business of horse racing and realises money both from the members and from non-members for the same consideration, namely, by the giving of the same or similar facilities to all alike in course of one and the same business carried on by it."

From the above extract of the judgment, it is crystal clear that 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. In the above case, this Court quoted with approval the three conditions stipulated by the Judicial Committee in the case of English & Scottish Joint Cooperative Wholesale Society Ltd. v. Commissioner of Agriculture Income-tax, Assam (1948 AC 405 at 419), existence of which establishes the doctrine of mutuality. They are as follows :- (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 and policy holders, 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.

If we apply the above three criteria to the facts of the case in hand then we find that the appellants business is governed by the doctrine of mutuality. That apart, this Court in the case of C.I.T. vs. Bankipur Club Limited (supra) also had an occasion to deal with the claims of a number of Clubs seeking benefits based on the principle of mutuality. In that case, this Court held :- 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.

In the same case while considering the case of the Cricket Club of India arising out of C.A. No.10194/95 and C.A. No.3382/97 (the facts of which cases are similar to the case with which we are concerned), it was held :-

> 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 Tribunal, Bombay Bench-A, for the assessment years 1974-75 and 1976-77 rendered in I.T.As. Nos.1730 and 1913/(Bombay) of 1980, the Appellate Tribunal held that no portion of the club house, Patiala Pavilion, etc. is let out to strangers and that these portions are let out only to the members and so, even if any income had actually accrued due from the members on the above counts, it will not be taxable on the principle 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. No.10194 of 1995 and the High Court declined to refer any question of law for this year as well. In fact, for 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 for its decision. (emphasis supplied).

From the above observations of this Court, it is clear that it is not only the surplus from the activities of the business of the Club that is excluded from the levy of income-tax even the annual value of the Club House, as contemplated in Section 22 of the Act, will be outside the purview of the levy of income- tax. To this extent also, we find that the judgment of the Allahabad High Court in the case of Wheeler Club (supra) is not a good law.

The High Court in the impugned judgment, apart from relying on the judgment of the Allahabad High Court in Wheeler Clubs case (supra) also relied on certain observations made by the same court in the case of C.I.T. v. Delhi Gymkhana Club Ltd. (155 ITR 373 at 376) which reads thus :

Letting out of the premises is merely a provision of a facility for members. The principle of mutuality clearly applies to the surplus earned as a result of such activities. It may be that if the income can be treated as rent derived from house property, the rent or the income derived from house property will be assessable under section

22. That may be so because of the statutory fiction contained in section 22 of the Act and the scheme of the I.T Act, that the income from house property will be assessable on notional basis.

In our opinion, the High Court in Delhi Gymkhana case (supra) has not laid down any principle of law. It has merely proceeded on a hypothesis. At any rate the conclusion based on that hypothesis, in our opinion, being opposed to the principle accepted by us in this judgment will not be of any assistance to the Revenue.

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 judgment impugned herein is set aside. The questions referred by the tribunal are answered in the affirmative and in favour of the appellant. On the facts and circumstances of these cases, the parties will bear their own costs.