PRINCIPLE OF MUTUALITY / MUTUAL CONCERNS

PRINCIPLE OF MUTUALITY:

- **No person can trade with himself or make income out of himself.**
- **A mutual association arises when a group of persons associate together:**
  - with a common object;
  - contribute monies for achieving that object; and
  - divide surplus amongst themselves.
- **The objective should not be profit. The objective should be social security, entertainment, professional development, etc.**
- **All the contributors to the common fund are entitled to participate in the surplus and all the participators to the surplus must be the contributors to the common fund.**
- **It is not necessary for the mutual concern to distribute the surplus immediately.** The participation in the surplus may be by way of reduction in future contributions or division of surplus on dissolution.
- **Mutual concern can be incorporated as a company.** Doing so does not destroy the identity of the contributors and participators.

INCOME EXEMPT FROM TAXATION:

- The income of a mutual concern is exempt from tax as far as it is derived from activities of mutual nature.
- **Also following incomes are exempt:**
  - Income received from members
  - Income from trading so far as it is confined to own members.

INCOME CHARGEABLE TO TAX:

- **Where the mutual concern is a trade, professional or similar association, then the income derived from specific services performed for its members is taxable as P/G/B/P under section 28.** However, if mutual concern is a resident welfare association, sports club, etc. then income derived from specific services performed for its members is not taxable.
- **Income received from non-members.**

TRADE & PROFESSIONAL ASSOCIATION:

- Trade and professional association means an association of traders or professionals for protection or advancement of their common interest.
- Any surplus arising to the trade or professional association from general activities i.e., entrance fees, etc. will not be taxable.
- Only the income arising from performing specific services to members is taxable and the expenditure to earn such income is deductible.

SPECIAL PROVISION CONTAINED IN SECTION 44A FOR TRADE & PROFESSIONAL ASSOCIATION

- **Applicable only to that trade, professional or similar association, the income of which is not distributed to its members.**
- Amount received by the association from its members by way of contribution or otherwise (other than amount received from performing specific services). i.e., **General receipts from members**
- **Less:** Expenditure incurred for the purposes of protection or advancement of interest of members (other than expenditure which is otherwise deductible under the Act and other than capital Expenditure), i.e., **General expenditure on member**

If negative - call it deficiency
If positive - surplus exempt from tax

- **Such deficiency will be allowed as a deduction in computing the income under the head P/G/B/P.**
- If deficiency is greater than income under the head P/G/B/P, then the balance deficiency will be allowed as deduction in computing income under **other heads of income.**
- **Before setting off the deficiency,** effect shall be first given to the **deductions under this Act and brought forward losses and allowances.**
- The total deficiency which can be set off shall not exceed **50% of the Total income computed before giving deduction of deficiency.**

KEY NOTES:

1. Tax rate applicable to a mutual concern shall be the same as applicable to an individual except where the mutual concern is incorporated as a company.
2. **BANKIPUR CLUB LTD. (SUPREME COURT)**
   Receipts for the various facilities extended by the clubs to its members, as part of the usual privileges, advantages and conveniences, attached to the membership of the club, could not be said to be "a trading activity." The surplus-excess of receipts over the expenditure - as a result of mutual arrangement, could not be said to be "income" for the purpose of the Act.
3. **BANGALORE CLUB (SUPREME COURT)**
   Interest earned by a club on fixed deposits kept with bank, which were its corporate members, would not be exempted from payment of income-tax on basis of doctrine of mutuality.

Funds of club in form of FDRs are expended on non-members i.e. that clients of the bank. Banks generate income by paying a lower rate of interest to club-assessee that makes deposit with them, and then loan out the deposited amounts at a higher rate of interest to third parties. This loaning out of funds of the club by banks to outsiders for commercial reasons, snap the link of mutuality and thus, breaches the concept of mutuality.

4. **INCOME-TAX OFFICER V. VENKATESH PREMISES CO-OPERATIVE SOCIETY LTD. (SUPREME COURT)**
Supreme Court's observations: The doctrine of mutuality is based on the common law principle that a person cannot make a profit from himself. The essence of the principle of mutuality lies in the commonality of the contributors and the participants who are also the beneficiaries. The contributors to the common fund must be entitled to participate in the surplus and the participators in the surplus are contributors to the common fund. Any surplus in the common fund shall, therefore, not constitute income but will only be an increase in the common fund meant to meet sudden eventualities.

The Supreme Court made the following observations:

- If for convenience, part of the transfer charges were paid by the transferee, they would not partake of the nature of profit. The amount is appropriated only after the transferee was inducted as a member. In the event of non-admission, the amount was returned. The moment the transferee was inducted as a member the principles of mutuality would apply.

- Non-occupancy charges were levied by the society and were payable by a member who did not himself occupy the premises but let them out to a third person. The charges were utilised only for common benefit of facilities and amenities to the members.

- Contribution to the common amenity fund taken from a member disposing of property was utilized for meeting heavy repairs to ensure hazard-free maintenance of the properties of the society which ultimately benefitted the members.

Accordingly, the transfer charges, non-occupancy charges, common amenity fund charges and other charges are exempt owing to application of the doctrine of mutuality.