REPORTABLE

* **IN THE HIGH COURT OF DELHI AT NEW DELHI**

ITA No. 1409 of 2008

% *Judgment Reserved on: 20th August, 2009*
Judgment Pronounced on : 25th September, 2009

COMMISSIONER OF INCOME TAX, Delhi-XI, New Delhi
. . . Appellant

through : Ms. P.L. Bansal with Ms. Anshul Sharma, Advocates.

VERSUS

STANDING CONFERENCE OF PUBLIC ENTERPRISES (SCOPE)
. . . Respondent

through: Mr. O.S. Bajpai, Sr. Advocate with Mr. V.N. Jha and Mr. Bibhuti Singh, Advocates.

CORAM :-
THE HON'BLE MR. JUSTICE A.K. SIKRI
THE HON'BLE MR. JUSTICE VALMIKI J. MEHTA

1. Whether Reporters of Local newspapers may be allowed to see the Judgment?
2. To be referred to the Reporter or not?
3. Whether the Judgment should be reported in the Digest?

A.K. SIKRI, J.

1. This appeal was admitted on 20.08.2009 on the following substantial questions of law:

   i) Whether the assessee society is a mutual concern so as to claim exemption on principle of mutuality?

   ii) Whether the ITAT was correct in law in holding that only rental income received by the assessee from non-members is chargeable to tax?

iii) Whether the ITAT was correct in law in holding that interest received by the assessee on FDRs/deposits was not chargeable to tax on principle of mutuality.

2. Since the counsel for both the parties were ready to address the arguments finally on the basis of records filed before us, we heard the arguments on that very day and reserved the judgment. We now proceed to answer the questions of law as framed.

3. Minimal factual matrix, that is required for this purpose is recapitulated in the first instance, as under:

The respondent/assessee is a society registered under the Societies Registration Act, 1860. It has been formed at behest of the Government of India to improve the performance of public enterprises and to improve its total role in conveying such information and advice to community and the Government and to general help public enterprises and other member organizations in their respective views. The membership of society is open to all public enterprises of Central/State Government. The objects of the society as stated in the Memorandum and Articles of Association are reproduced below for ready reference:

i) "To adjust and/or settle controversies between members of the society. If called upon by the parties to do so or when reference is made by them to the society;

ii) To convene and hold conference and organize seminars on matters pertaining to or connected with industry

business, trade, national economy, public enterprises and matter incidentally thereto;

iii) To undertake sponsor or arrange training programmes for the benefit of diverse levels of management with a view to promote better management techniques in public enterprises;

iv) To initiate, sponsor and/or undertake research projects on diverse matters related to or connected with public enterprises;

v) To promote better understanding of the role and performance of public enterprises among public at large both in India and abroad and to stimulate, encourage and provide knowledge and information pertaining to public enterprises in India; by organizing lectures, study groups, discussions, deliberations, correspondence, seminars and conferences by providing libraries and film units and by arranging the publication of newspapers, periodicals, books, brouchers or any of the rallied material; by endowment of professorship, studentship and scholarship; by organizing and/or participating in exhibitions in India and abroad; by opening information centers and display centres and by undertaking such other activities as may be necessary in the interest of public enterprises;

vi) To provide rooms and other facilities for holding, conducting or promoting the business of public enterprises;

vii) To prepare a code of practice to simplify and facilitate transaction of business of public enterprise;

viii) To establish and maintain such advisory or consultative cells or panels or experts including arbitrators which may be of general use to the society or its members;

ix) To undertake, sponsor, support tor aid any educational, social, commercial or industrial activity which may serve the interest of public enterprises;

x) To do or to cause to be done Assessment Year or all such acts or things as shall be conductive to the welfare of the society, provided such acts or things shall not be contrary to nor inconsistent with the spirit of the laws under which the society has been organized and registered. The society shall have perpetual succession

> by its corporate name. But if in the course of time there should be dissolution of the society and if thereupon there shall remain after the satisfaction of Society's debts and liabilities and property whatsoever the same shall not be paid to or distributed among the members of the society but shall be given or transferred to some other institution or institutions having objects similar to the objects of the society to be determined by the members of the society at or before the time of the dissolution and in default thereof by a competent Court of law, as may have the jurisdiction in the matter."

4. The assessee has its building at Lodhi Road, New Delhi. Its income is mainly from interest from deposits with bank, rent from use of the convention centre and from letting out of the part of the premises of the aforesaid building as well as subscriptions received from the members.

5. The assessee had claimed the entire income exempt from tax on the 'principle of mutuality'. This claim of the assessee was accepted in the original assessment for the year 1999-2000, with which we are concerned in the present appeal. However, while making assessment for the Assessment Year 2003-04, the Assessing Officer came to the conclusion that the interest income, the receipt from convention centre for use by non-members and rent received from letting out a part of the society's premises were taxable. Following this decision, the Assessing Officer reopened the assessment for the assessment year 1999-2000 as well, by issuing notice under Section 148 of the Act

on 28.03.2006. The assessee in response thereto filed the return declaring 'NIL' income, again taking up the plea of mutuality.

6. The AO framed fresh assessment order dated 29.12.2006 observing that the assessee had treated the members and non-members alike. He noted that the activities of this society were not limited to the members and in fact, it was receiving income operation from non-members also. He also observed that as per Clause (xxiv) of MOA, in case of dissolution, surplus was not to be apportioned amongst members but was to be transferred to other Society having similar objects. He also observed that the assessee had apportioned expenditure but not the receipts. Accordingly, he held that the assessee was not a mutual concern and he treated interest income as "Income from Other Sources", rental income as "Income from House Property" and balance income as "Business Income". The explanation of the assessee that the society was a mutual concern and it was not carrying out any business activity and the surplus income was not distributable amongst members, did not find favour with the AO. The AO was also not deterred by the contention of the assessee that in the case of assessee itself for the assessment year 1975-76, the Tribunal had held that income of the society to be exempt on the principle of mutuality. Negativing this plea, he observed that subsequent to the assessment year 1975-76, there had been changes in

factual and legal position. The assessee was not receiving income from letting out of convention centre and other premises on rent, huge interest income and had also constructed the tower. The legal position had also changed in view of the subsequent judgment of Hon'ble Supreme Court in the case of ***Commissioner of Income-tax, Bihar*** v. ***M/s. Bankipur Club Ltd.***, 226 ITR 97 in which it was held that income from non-members could be brought to tax and the claim of mutuality would not apply to such transactions.

7. After rejecting the plea of mutual concern, the AO examined the various activities undertaken by the assessee. He found that it had three divisions, Scope Secretariat, Scope (MMO) and scope minar. In scope secretarial, the assessee society had income from subscription and interest etc. The receipts in Scope (MMO) were from rent from letting out of premises and the conventional centre as well as interest income. In scope minar, receipts were from interest from surplus funds deposited with banks. The total interest income form all the three divisions was Rs.38,355,413/-. In addition, the society had rental income of Rs.26,17,822/- form the use of convention centre and Rs.76,88,328/- from use of other premises which included a sum of Rs.2,05,200/- from a non-members, i.e., M/s. Lacisine Pvt. Ltd. to whom the premises had been let out for providing catering facilities to organizations availing of the society. Further, the society had

surplus of Rs.6,21,702/- in the Scope Secretariat account after excluding the interest income. The AO, however, noted that there was a provisions of Rs.1 lacs onwards gratuity in the account of scope Secretariat, which he held was not allowable and therefore, he computed the surplus in that account at Rs.7,21,702/-, which was taxed by him as income from business. The interest income was assessed by him as income from other sources. He also observed that the rental income received from non-members as well as the members was tainted with commerciality as the members such as State Bank of Hyderabad, Dena Bank and Balmer Lawrie who had used the space had used it only as a businessman and not as a member. Moreover, they were governed by the companies Act. Therefore, the AO assessed the rental income as income from house property.

8. The assessee disputed the aforesaid order of the AO in appeal preferred before the CIT(A). This appeal was, however, dismissed thereby affirming the assessment order passed by the AO. In further appeal preferred by the assessee, the assessee has achieved partial success inasmuch as the Tribunal has allowed the appeal partially. It is held that even on the application of principle of mutuality was laid down by the Supreme Court in **Bankipur Club** (supra) and when that judgment is correctly interpreted, the principle of mutuality

would apply. In the opinion of the Tribunal, it was because of the reason that the assessee was not doing any commercial activity. The Revenue is in appeal before us challenging the aforesaid order.

9. From the order of the Tribunal, it would be clear that the income in the form of rent and license fee received from non-members is treated as exigible to tax and no exemption is granted in that behalf. However, other income, viz., interest income from surplus funds deposited with banks, rental income from the members which is let out part of the premises, rental income from members form the use of convention centre and other premises is treated as exempted by applying the principle of mutuality. As per the AO, the activities of the assessee society were not limited to the members only, but encompassed the community at large as per Clause (v) of the Memorandum, which provided for promotions of better understanding of the role and performance of public enterprises among public at large in India and abroad and to stimulate, encourage and provide knowledge and information pertaining to public enterprises in India by organizing lectures, study group etc. He was also influenced by the fact that the rental income even received from members had an aspect of commerciality, as members like State Bank of Hyderabad, Dena Bank and Balmer Lawrie had used this place only a business and not as members. Swayed by

these reasons, the AO was of the opinion that the activities of the respondent/society were tainted with commerciality which destroyed the principle of mutuality and thus the judgment of the Supreme Court in **Bankipur Club** (supra) was clearly applicable. The Tribunal, while arriving at a contrary finding has held that the assessee had not done any business and allowing the premises to non-members when the same were lying idle, would not make the activities of the assessee as commercial activity.

10. Thought process of the Tribunal, in this behalf, is reflected in the following discussion contained in the impugned order, which follows as under:

> "So far as the present case is concerned, the assessee had not done any business. It had only allowed use of premises to non-members when the same were lying idle with a view to proper utilization of facilities. Merely on this ground, in our view, it will not appropriate to treat the activities of the assessee society as commercial activity."

11. Applying the aforesaid principle, the Tribunal held that interst income from surplus funds would be exempted, as held by this Court in the case of ***Director of Income Tax (Exemptions)*** v. ***All India Oriental Bank of Commerce Welfare Society***, 184 CTR 274. However, it also held that the rental income received from non-members for use of convention centre and from M/s. Lacisine Pvt. Ltd. to whom the premises were let out for providing catering services was not to be

exempted, as rental income from non-members was taxable. It is because of this reason the appeal was partially allowed.

12. Before the CIT(A) as well as the Tribunal, the plea of the assessee was that since principle of mutuality was applicable, the entire income under the aforesaid head was to be exempted. It was further pointed out that, in any case, only a sum of Rs.12.78 lakhs was received from non-members as rental income and raised all the amount on this account was received from members. Likewise, a sum of Rs.2,05,500/- was received from M/s. Lacisine Pvt. Ltd. as license fee for providing catering to the members.

13. The position can, thus, be summarized as under:

The assessee in its return for the Assessment Year 2003-04 had claimed the entire income be exempted from tax on the principle of mutuality. The income was generated by the assessee in this year was from the following sources:

i) Rental income from the use of convention centre and other premises given to the members;

ii) Rental income for use of convention centre and other premises, from non-members;

iii) License fee from M/s. Lacisine Pvt. Ltd. in sum of Rs.2,05.200/- by letting out the premises for providing catering facilities;

iv) Interest income;

v) Surplus of Rs.6,21,702/- + Rs.1 lac as provision made for gratuity in the Scope Secretariat.

The AO declined to accept the contention that principle of mutuality was applicable and therefore, treated the entire income a taxable either as "income from other sources or as income from house property" "business income". The Tribunal has, however, accepted that principle of mutuality would apply except in respect of the income in the form of rental or license fee collected from non members. Thus, all other incomes except income generated from non-members is treated as exempt from tax holding that the assessee would be liable to pay the tax in respect of receipts from non-members. Thus, there is no dispute that the other income, which is treated as exempt, are the receipts from the members or the interest earned from surplus funds deposited with the banks. Learned counsel for the parties agree that the issue as to whether these receipts were exigible to tax or not would depend upon the application of principle of mutuality, viz., if the principle is applicable, the aforesaid incomes would exempt from tax.

14. In **Bankipur Club** (supra), principle of mutuality was elaborately discussed. In this case, the Supreme Court explained that 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 n 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.

The Supreme Court also quoted the following passage from *Simon's Taxes,* Volume B, Third edition:

> "...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 contributions 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...."

Quoting from British Tax Encyclopedia (I) 1962 edition, the Court noted that this doctrine had 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....

The Court was also of the opinion that:

> "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 Court opined that even if some income is generated by extending facilities to the members, such surplus/excess of receipts over expenditure would not be treated as income for the purpose of Income Tax Act, as the extension of such facilities, as part of usual privileges, advices and conveniences attached to the membership of the club cannot be said to be "a trading activity".

15. It was also held that where such member clubs or mutual associations extend facilities to non-members, to that extent, the element of mutuality is wanting.

16. The relevant para on which strong reliance was placed by the AO as well as the learned counsel for the Revenue before us is para 15, which reads as under:

> "15. Our attention was invited to a few decisions which have dealt with the subject matter in issue herein. The gist 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 : [1953]24ITR551(SC) ; Commissioner of Income-tax. Madras v. Kumbakonam Mutual Benefit Fund Ltd.: [1964]53ITR241(SC) , Fletcher (on his own behalf and on behalf of Trustees and Committee of Doctor's Cave Bathing Club v. Income Tax Commissioner [1971] 3 All ER 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 alike is 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 vexed 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]."

17. In ***Chelmsford Club*** [2000] 243 ITR 89, the Supreme Court clarified that even if such a association is an incorporated company, that

would be immaterial if there is identity in character of those who contribute and those who participate in surplus. The can be traced out from the following observations:

> "… 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. Their Lordships have laid down the three test before the principle of mutuality can be applied. In a nutshell, these test are:
>
> 1. The identity of the contributors to the fund and the recipients from the fund.
> 2. The organization exists only for mutual benefit.
> 3. The funds can be expended for mutual benefit or returned to the contributors."

18. At this stage, we may also take note of the judgment of Gujarat High Court in the case of ***Sports Club of Gujarat*** Vs. ***CIT*** where the Court held that the principle of mutuality is not destroyed by the presence of transaction, which are non mutual in character. This principle can, in such case, be confined to transactions with members. The two activities, in appropriate case be supported and the profits derived from non-members, can be brought to tax.

19. In the present case, as already noted above, the respondent is incorporated as a society and the main objective is to improve the purpose of public enterprises. The membership of the society is open to public sector enterprises of Central/State Governments. It is, thus, performed for the benefit of its members, which are public sector

enterprises. It is not indulging in any "commercial activities" in traditional sense, but is catering to the needs of its members. In its building at Lodhi Road, New Delhi, it has convention centre which is normally given to its members for functions. Likewise, other part of the premises are available to the members for their use. Of course, for using convention centre as well as other parts of the building, these members pay some charges which becomes additional source of income. That by itself cannot be treated as commercial activity of the assessee. In **Bankipur Club** (supra), the Supreme Court held that if the dealings as a whole disclose the profit earning motives and are alike tainted with commerciality, only then principle of mutuality would cease to apply. The principle in this behalf was discerned as under:

> "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 alike is a trade/business/transaction and the resultant surplus is certainly profit - income liable to tax."

20. Thus, such company claiming to be mutual concern or club whose object is to carry on particular business or where the income is

generated from members and non-members through the business carried on by it, then only it would be treated as tainted with commerciality. Profit earning has to be the prime motive behind such activities, which are business like activities. Obviously in the present case, this cannot be attributed to the assessee. The AO got influenced by the fact that the assessee had let out part of the premises to its members and was receiving rents and also giving the convention centre to non-members. That is not sufficient to clothe the activity of the assessee as commercial activity, which is not the object with which the assessee society is formed. Pre-dominant object is to render appropriate assistance and help to its members for improving their performance and role. Thus, all the three ingredients laid down by the Supreme Court in **Chelmsford Club** would be applicable in the present case.

21. We may also refer to the judgment of the Calcutta High Court in the case of ***Dalhousie Institute*** Vs. ***Asstt. Commissioner, Service Tax Cell***, 2006 (3) STR 311. Though it was a case where 'mandap' facilities were provided by the club to its members and the question of service tax had arisen, the Calcutta High Court applied the principle of mutuality holding that the aforesaid facilities provided by the club to its members for such functions cannot be termed as

commercial activity. Following observations are to be noted in this behalf:

> "The principle of mutuality in this case is also squarely applicable, as going by the definitions of mandap, mandap keeper and the taxable service, in this case the facility of use of the premises to the members by its club cannot be termed to be a letting out nor the members of the club using the facility of any portion of the premises for any function can be termed to be a client. The services rendered by any person to his client presupposes the element of commerciality and obviously this transaction must be involved with the third parties, as opposed to the members of the club."

Similar question was answered in the case of ***Saturday Club Ltd.*** Vs. ***Asstt. Commissioner, Service Tax Cell,*** (2006) 3 STR 305 in the following manner:

> "So far as the merit is concerned, law is well settled by now that in between the principal and agent when there is no transfer of property available question of imposition of service tax cannot be made available. It is true to say that there is a clear distinction between the 'members club' and 'proprietary club'. No argument has been put forward by the respondents to indicate that the club is a proprietary club. Therefore, if the club space is allowed to be occupied by any member or his family members or by his guest for a function by constructing a mandap, the club cannot be called as mandap keeper, because the club is allowing his own member to do so who is, by virtue of his position, principal of the club. If any outside agency is called upon to do the needful it may raise a bill along with the service tax upon the club and the club as an agent of the members, is supposed to pay the same. The authority cannot impose service tax twice once upon the people carrying out the business of 'mandap keeper' as well as the members' club for the purpose of using the space for constructing or using it as 'mandap'. Therefore, apart from any other question possibility of double taxation cannot be ruled out. If I explain my first query as above it will be crystal clear that if a person being an owner of the house allows another to occupy the house for the purpose of carrying out any function in that house it will not be construed as transfer of property. But if such person calls upon a third party 'mandap keeper' to construct a 'mandap' in such house then in that case such 'mandap keeper' can be able to raise bill upon the user of the premises along with the service

> tax. Therefore, I cannot hold it good that members' club is covered by the Finance Act, 1994 for imposition of service tax to use its space as 'mandap'. So far as the other point is concerned whether the ratio of the judgments can be acceptable herein or not I like to say 'yes it is applicable'. Income-tax is applicable if there is an income. Sales tax is applicable if there is a sale. Service tax is applicable if there is a service. All three will be applicable in a case of transaction between, two parties. Therefore, principally there should be existence of two sides /entities for having transaction as against consideration. In a members' club there is no question of two sides. 'Members' and 'club' both are same entity. One may be called as principal when the other may be called as agent, therefore, such transaction in between themselves cannot be recorded as income, sale or service as per applicability of the revenue tax of the country. Hence, I do not find it is prudent to say that members' club is liable to pay service tax in allowing its members to use its space as 'mandap'."

22. Therefore, simply because some incidental activity of the assessee is revenue generating, does not provide any justification to hold that it is tainted with "commerciality" and reaches a point where relationship of mutuality ends and that of trading begins.

23. We, thus, answer the question in affirmative, i.e., in favour of the assessee and against the Revenue. As a consequence, this appeal is dismissed with costs.

(A.K. SIKRI)
JUDGE

(VALMIKI J. MEHTA)
JUDGE

September 25, 2009.
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