IN THE HIGH COURT OF JUDICATURE AT BOMBAY

ORDINARY ORIGINAL CIVIL JURISDICTION

INCOME TAX APPEAL NO.2060 OF 2009

The Commissioner of Income Tax,

City – 10, Aayakar Bhavan,

4th Floor, M.K. Marg,

Mumbai – 400 020 ..Appellant.

Versus

M/s.Common Effluent Treatment Plant,

(Thane Belapur) Association,

P-20, Anand Bhakamkar Common

Facility, Centre Khairne, M.I.D.C.,

Navi Mumbai – 400 705 ..Respondent.

Mr.Suresh Kumar for the appellant.

Mr.S.N. Inamdar with Ms.Aasifa Khan for the respondent.

CORAM : Dr.D.Y. Chandrachud &
J.P. Devadhar, JJ.

DATE : 17 June, 2010.

ORAL JUDGMENT (Per Dr.D.Y. Chandrachud, J.)

1. Leave to amend the questions of law is granted. Amendment to be carried out during the course of the day, in terms of the draft amendment tendered on record. Verification is dispensed with.

2. This is an appeal by the Revenue under Section 260A of the Income Tax Act, 1961 against a decision of the Income Tax Appellate Tribunal (Tribunal) for assessment year 2001-2002. During the course of the hearing, Counsel appearing on behalf of the Revenue and Counsel appearing on behalf of the assessee addressed the Court on two issues. In view of the submissions which have been urged before the Court, the questions of law raised in the appeal have been re-framed thus with the consent of Counsel appearing on behalf of the Revenue and Counsel appearing for the assessee :

A) Whether on the facts and in the circumstances of the case, the Tribunal was justified in holding that the excess of income over expenditure in respect of the effluent treatment receipts is exempt from income-tax on the principle of mutuality;

B) Whether the Tribunal was justified in holding that interest on bank fixed deposits, other deposits and income-tax refunds is not chargeable to tax on the principle of mutuality;

3. The assessee is an Association incorporated under Section

25 of the Companies Act, 1956. The members of the assessee are industries operating in the Thane-Belapur region. The assessee was set up with a view to provide a centralized treatment facility for industrial effluents and was incorporated on 12 October 1994. The objects underlying the establishment of the assessee, as stated in the Memorandum of Association (MoA), are as follows :

> "A. THE MAIN OBJECTS OF THE COMPANY TO BE PURSUED BY THE ASSOCIATION ON ITS INCORPORATION :
>
> 1. To constitute and maintain an organization for treatment of Industrial Effluents generated by all those User Members engaged in the manufacture of various products and engaged in Industrial processes in the Trans Thane Creek Industrial Area.
>
> 2. To act as an advisor for the process and treatment of all kinds of pollution such as Air Pollution, Water Pollution, Waste Water Pollution, Sewage, Industrial Hazardous Solid Wastes, Chemicals, Gases Effluents from Industries, and all other kinds of environmental pollution related to the effluent treatment plant".

4. For assessment year 2001-2002, the assessee filed a return of income declaring the total income at Nil, on the principle of mutuality. The Assessing Officer rejected the claim of the assessee. The Commissioner (Appeals) by his decision dated 20 October 2003 noted that the assessee owes its formation to increased levels of pollution in the Trans-Thane Creek Industrial Area; stringent norms for the control of effluents prescribed by the Maharashtra Pollution Control Board; the

inability of each individual unit to set up a separate industrial effluent treatment facility; and the policy of the Union Ministry of Environment and Forests to encourage the establishment of Common Effluent Treatment Plants. The Commissioner (Appeals) held that the treatment cost is recovered only from user members of the assessee and that the principle of mutuality was established since there was a complete identity between contributors and participators. On this ground, the Commissioner (Appeals) directed that the excess of income over expenditure (excluding interest on fixed deposits held with banks and others) was not exigible to tax in the hands of the assessee. However, the Commissioner (Appeals) came to the conclusion that the interest income of the assessee amounting to Rs.45.46 lakhs on fixed deposits and other deposits and on income-tax refunds was taxable under the head of income from other sources. The decision of the Commissioner (Appeals) was questioned before the Tribunal both on behalf of the Revenue and the assessee. The Tribunal by its decision dated 6 February 2007 confirmed the decision of the Commissioner in so far as it applied the principle of mutuality to the excess of income over expenditure. The Tribunal noted that the assessee is a non-profit company formed by units engaged in industrial activity with the object of setting up a common effluent treatment facility. The Tribunal confirmed the finding that there is a complete identity between contributors and participators and was consequently of the view that

the principle of mutuality was attracted. On the second question, the Tribunal held that since the principle of mutuality was applicable, interest on bank fixed deposits, other deposits and income-tax refunds was also not chargeable to tax. The appeal by the Revenue was dismissed and the appeal of the assessee was allowed.

5. The Revenue is in appeal before this Court. The first question of law that has been raised before the Court is as to whether the Tribunal is in error in holding that the principle of mutuality would apply to the excess of income over expenditure; the income representing contributions received from members. The second question of law relates to the treatment that is to be afforded to the interest received on bank and other deposits and income-tax refunds. It would be appropriate to deal with the two questions of law separately.

RE : QUESTION A

6. The factual position as it emerges from the record before the Court is that the assessee is a company incorporated under Section 25 of the Companies Act, 1956. The assessee is an Association formed with the object of setting up an effluent treatment plant for the members of the assessee, who run industrial units in the Trans Thane Creek Area. The income of the assessee consists of contributions by members made for the purposes of setting up the effluent treatment

facility. The Association collects contributions in excess of what is required to be expended. The case of the assessee is that the treatment costs recovered are generally maintained at such a level, that recoveries are normally more than the expenses of that year so as to ensure that funds are available to meet a part of the capital cost. According to the assessee, the capacity of the Effluent Treatment Plant installed initially was 12 mld which became insufficient to handle the effluents generated and a result an additional plant was required. Moreover, a surplus is required to ensure that funds are available to meet sudden eventualities such as major repairs and replacement expenses. The underground pipeline for the supply of effluents is stated to be over 30 years of age and the assessee maintains a surplus to deal with unforeseen situations. The assessee does not collect any contributions from third parties and the entire contribution originates from its members. The contribution is expended only for meeting the objects of the Association, for the benefit of the members. According to the assessee, there is an absolute identity between the contributors and the participators and, as a result, the principle of mutuality would stand attracted.

Mutuality :

7. The principle of mutuality postulates that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus are contributors to

the common fund. It is in this sense that the law postulates that there must be a complete identity between the contributors and the participators. The essence of the doctrine of mutuality lies in the principle that what is returned is what is contributed by a member. A person cannot trade with himself. It is on this hypothesis that the income which falls within the purview of the doctrine of mutuality is exempt from taxation.

8. In ***Commissioner of Income Tax V/s. Bankipur Club Limited***[1], the Supreme Court considered as to whether a surplus of receipts over expenditure generated from the facilities extended by a club to its members were exempt on the ground of mutuality. The Supreme Court reiterated the principle that in the case of a mutual society, there must be a complete identity between the class of contributors and of participators. The main object of the club, noted by the Supreme Court, was to afford to its members the usual privileges, advantages, conveniences and accommodation provided by the club. The amounts received by the club were for the supply of drinks, refreshments or other goods from the members of the club. These being charges for the privileges, conveniences and amenities provided to members, such services, as observed by the Supreme Court, were not provided with a profit motive and were not tainted by commerciality.

1 (1997) 92 Taxman 298

This, therefore, did not constitute a trading activity and the surplus of receipts over expenditure, generated as a result of such a mutual arrangement, did not constitute income for the purposes of the Act. In ***Chelmsford Club V/s. Commissioner of Income Tax***[2], the Supreme Court held that "the law recognises the principle of mutuality excluding the levy of income-tax from the income of such business to which the .... principle is applicable". Adverting to the judgment of the Privy Council in ***English and Scottish Joint Co-operative Wholesale Society Limited V/s. Commissioner of Agricultural IT***,[3] the Supreme Court adopted the existence of the following principles as establishing mutuality : "(i) the identity of the contributors to the fund and the recipients from the fund, (ii) the treatment of the company, though incorporated as a mere entity for the convenience of the members and policyholders, in other words, as an instrument obedient to their mandate, and (iii) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves."

9. A Division Bench of the Gujarat High Court in ***Sports Club of Gujarat V/s. Commissioner of Income*** *Tax*[4] held that one of the essential requirements of mutuality is that the contributors to the

2 (2002) 243 ITR 89 (S.C.)
3 (1948) 16 ITR 320 (PC)
4 (1988) 37 Taxman 38 (Guj.)

common fund are entitled to participate in the surplus thereby creating an identity between participators and the contributors. Once such an identity is established the surplus income would not be exigible to the tax on the principle that no man can make a profit out of himself.

10. Applying the principle which has been enunciated by the Supreme Court, there can be no manner of doubt that the surplus generated by the assessee representing the excess of its income over expenditure would fall within the purview of the doctrine of mutuality. For the purposes of the first issue, it must be noted that this income is exclusive of interest which is earned on fixed and other deposits and on refund of income-tax which would be dealt with separately. The income of the assessee is contributed by its members. The assessee has been formed specifically with the object of providing a common effluent facility to its members. The income is not generated out of dealings with any third party. The entire contribution originates in its members and is expended only in furtherance of the objects of the Association, for the benefit of the members. On these facts, both the Commissioner (Appeals) and the Tribunal were justified in coming to the conclusion that the surplus so generated falls within the purview of the doctrine of mutuality and was not exigible to tax. The first question of law would accordingly have to be answered in favour of the assessee and against the Revenue.

RE : QUESTION B

11. During the assessment year, the assessee earned interest on bank deposits, other deposits and income-tax refunds amounting to Rs. 45.46 lakhs. The submission which has been urged on behalf of the Revenue is that (i) The interest income does not satisfy the test of mutuality since the income is generated not from the members of the assessee but from third parties such as banks with whom the surplus is kept in fixed deposits; (ii) Clause 15 of the Memorandum of Association enables the assessee to invest any money of the Association in one or more of the modes of investment specified therein, which include deposits with a Government company and the holding of securities and investments authorized by law. An investment made in pursuance of the provisions of clause 15 of the MoA will not meet the test of mutuality since interest is earned out of a commercial decision of the assessee to invest in such deposits for the purposes of earning interest; (iii) The predominant view on the question as to whether interest on bank deposits falls within the principle of mutuality is that of the High Courts of Madras, Karnataka, Gujarat and Jammu & Kashmir, which have held that interest earned on surplus funds parked with a bank does not satisfy the test of mutuality.

On the other hand, it has been urged on behalf of the

assessee that : (i) The source of funds invested in bank deposits is the contribution made by the members of the assessee; (ii) The surplus is maintained in order to deal with uncertain eventualities that are likely to arise in the functioning of the Effluent Treatment facility; (iii) The assessee as a Section 25 company is under a statutory obligation to hold its surplus funds with a Scheduled Bank under Section 35 of the Bombay Public Trust Act, 1950; (iv) The tenor of clause 15 of the MoA merely contemplates that the assessee may invest its funds as a matter of efficient handling. In other words, the submission of Counsel for the assessee is that the actual nature of the activity, the source of funds and the manner in which the funds are spent should lead to the conclusion that the earning of interest was motivated by an efficient utilization of the funds of the assessee during the period when they are surplus to needs. The earning of interest, it was urged, is not branded with a taint of commerciality.

12. Clause 15 of the MoA provides that any money of the Association may be invested in certain specified modes :

> "15. Any money of the Association may be invested in or upon any one or more of the following securities or modes of investments with power from time to time to vary such investments and securities held by the Association for others of the character hereby authorized :-
>
> i) Deposits with any Government Company.

ii) Purchase of ownership or other flats in any co-operative Housing Society or other organization for running the activities of the Company.

iii) Any other securities or investments authorized by law.

iv) To invest the funds of the Company not immediately required in accordance with the pattern laid down u/s.11(5) of the Income-Tax Act, 1961 as amended from time-to-time and/or as may be directed by any authority or authorities under the Income Tax Act, 1961, and/or any other law for the time being in force concerning the name".

13. Several High Courts have considered the question whether interest earned on surplus funds originating in the members' contribution of a mutual association is exigible to income tax. The Gujarat High Court had occasion to consider the question in Sports Club of Gujarat Limited V/s. Commissioner of Income Tax (supra). A Division Bench of the Gujarat High Court noted that in that case, the objects clause of the Memorandum and Articles of Association empowered the management of the assessee to invest in and deal with the moneys of the club not immediately required, in such a manner as may from time to time be determined by it. Under the clause, investment was not confined to the holding of fixed deposits in banks but could take any other form or shape including an investment in shares or real estate. In that context, the Gujarat High Court held as follows :

"..... When income is derived from such

> investment, whether by way of interest, dividend or rent, it is derived from a third party and is not by way of contribution from the members of the club".

Apart from the fact that in that case the object clause empowered the management to invest surplus funds in several categories of investment, the Division Bench also noted that the surplus, if it remained after satisfying the debts and liabilities was to be distributed amongst the members in equal shares.

14. Counsel appearing on behalf of the assessee sought to distinguish the judgment of the Gujarat High Court on the ground that in the present case, unlike in the case before the Gujarat High Court, clause V (6) postulates that upon winding up or dissolution of the assessee, the surplus after meeting debts and liabilities is not to be distributed amongst the members but is to be transferred to another company having similar objects as determined by the members of the company. We are of the view that the principle enunciated in the judgment of the Gujarat High Court cannot be distinguished on that ground because the principal basis of the determination of the Gujarat High Court was that when income is derived from an investment whether by way of interest, dividend or rent, it is derived from a third party and it is not by way of contribution from the members of the club. The principle of mutuality will hence not apply to such income.

15. The Karnataka High Court dealt with the issue in three decisions.

In ***Commissioner of Income Tax V/s. I.T.I. Employees Death & Superannuation Relief Fund***,[5] a fund was created by the employees of the Indian Telephone Industries and interest was generated by making deposits by investment in a bank. A Division Bench of the Karnataka High Court noted that the ingredients of mutuality were missing in that case since apart from the contributions made by the members, there were other sources of funding for the trust fund. The Division Bench was of the view that income was earned by making deposits by way of investment in the bank and that was a case where the assessee had invested its surplus funds and earned interest on these deposits. The High Court held that the principle of mutuality could be confined to the surplus which has accrued to the club out of the contributions received from the members but, this principle would have no application to the surplus received from non-members. The tax was sought to be levied not on the surplus arising from the contributions made by the members or from interest earned on the moneys contributed by the members. On the other hand, the deposits in banks were made for earning interest by way of income. The principle that no person could trade with himself would not arise as

5 (1998) 101 Taxman 315 (Kar.)

moneys were invested by the assessee with the bank to earn income, to enable the assessee to discharge its obligations. Consequently, the income earned from an outside agency by way of interest would not be covered by the principle of mutuality.

In ***Commissioner of Income Tax V/s. Bangalore Club***[6], the assessee was a club which was registered under the Societies' Registration Act and its members included four Scheduled Banks. The surplus which was generated during the course of assessment year 1989-90 was held in fixed deposits with the four banks and the interest that was generated thereon was claimed not to be exigible to tax on the principle of mutuality. A Division Bench of the Karnataka High Court held, after adverting to the decisions of the Supreme Court, that what had been done by the club is similar to what could have been done by a customer of a bank. The principle that no man can trade with himself would not be applicable where the deposit was held by a nationalized bank with its customers since the prevailing relationship was that of a banker with its customer.

16. The Karnataka High Court distinguished the judgment in the I.T.I. Employees' case in a subsequent decision in ***Canara Bank Golden Jubilee Staff Welfare Fund V/s. Deputy Commissioner of***

6 (2006) 156 Taxman 323 (Kar.)

Income Tax[7]. In that case the assessee was a registered society comprising of the employees of the Canara Bank, and was established with the object of promoting welfare amongst the members who contributed towards the corpus fund. The Assessing Officer taxed the interest income on investments and dividend income on shares. The appeals of the assessee were dismissed by the Commissioner and by the Tribunal. The question before the High Court inter alia was whether the principle of mutuality would apply. The Karnataka High Court noted that during the assessment years in question the source of funds was exclusively the members and no outsiders had contributed. The High Court was of the view that it was the contribution of the members which had formed the corpus of the fund. A portion of the fund which was not advanced to the members was invested. The High Court noted that the investment was "as a precaution for the purpose of keeping it in safe custody and not with an intention to derive a profit by way of interest". The High Court distinguished the decision in the case of I.T.I. Employees and came to the conclusion that taking into consideration the objects of the assessee, the source of funds during the relevant years and applicability of the funds for the benefit of the members, the principle of mutuality was attracted.

17. The Madras High Court considered a similar issue in

7 (2009) 243 ITR 89 (SC)

Madras Gymkhana Club V/s. Deputy Commissioner of Income-tax[8]. The question for consideration before the Division Bench was whether interest earned on surplus income derived in the course of the activities of the club and invested in fixed deposits would satisfy the test of mutuality. The Division Bench of the Madras High Court considered the decisions of the Karnataka High Court both in the case of I.T.I. Employees and in Bangalore Club. The Madras High Court held that though the club existed for the mutual interest of its members, on the basis of this alone it could not be held that the other activities such as financial management of depositing surplus funds in banking institutions and earning a substantial amount by way of interest should also be regarded as possessing a nexus to the regular activities of the club in relation to its members. The High Court observed that it was not the case of the assessee that the funds which were invested in the form of fixed deposits were so maintained with a definite idea of using them for a specific project or for the development of the infrastructural facilities of the club. The Karnataka High Court was of the view that such investments in fixed deposits could not be equated within or brought within the concept of mutuality and the benefit of tax exemption could not be extended in respect of the interest earned on surplus income. The Madras High Court was not inclined to follow the decision of the Karnataka High Court in the Canara Bank case and

8 (2009) 183 Taxman 333 (Mad.)

confined it to the special facts as they appeared before the High Court there.

18. The High Court of Jammu & Kashmir held in ***Amar Singh Club v/s. Union of India***[9] that interest received on fixed deposits and bank deposits would not be covered by the principle of mutuality. The High Court observed that there was no statutory obligation on the part of the assessee to make such deposits. The principle of mutuality could be applied only if interest was earned for advances / facilities of loan given to the members of the club.

19. Our attention has been drawn to the judgment of the Delhi High Court in ***Commissioner of Income Tax V/s. Standing Conference of Public Enterprises (Scope)***[10]. This decision of the Delhi High Court appears to have been based on a concession made before the Court on behalf of the Revenue and the assessee. Before the Delhi High Court, parties agreed that the issue as to whether receipts on account of interest earned from surplus funds deposited with the banks would be taxable would follow by the application of the principle of mutuality. The Delhi High Court was of the view that simply because some incidental activity of the assessee is revenue generating that does not give any justification to hold that it is tainted with commerciality and

9 (2009) 184 Taxman 481 (J&K)
10 (2009) 319 ITR 179 (Del)

reaches the point where a relationship of mutuality ends and that of trading begins.

20. On behalf of the assessee, it has been urged before the Court that exigibility to tax of interest earned on fixed deposits placed with a bank on the surplus funds of the assessee is not res-integra in view of the judgment of the Supreme Court in ***Commissioner of Income Tax V/s. Cawnpore Club Limited***[11]. The judgment of the Supreme Court is as follows :

> "1. One of the questions which the High Court had decided in other cases relating to the same assessee was that the doctrine of mutuality applied and, therefore, the income earned by the assessee from the rooms let out to its members could not be subjected to tax. No appeal had been filed against the said decision and the matters stood concluded as far as the assessee was concerned. This being so, no useful purpose would be served in proceeding with the appeals on the other questions when the respondent cannot be taxed because of the principle of mutuality.
>
> 2. The appeals were accordingly dismissed."

21. Now, from the judgment of the Supreme Court it is evident that the High Court had held, in other cases relating to the same assessee, that the doctrine of mutuality applied and, therefore, the income earned by the assessee from the rooms let out to its members could not be subjected to tax. The Supreme Court noted that no appeal had been filed against that decision and the issue stood concluded in so

11 (2004) 140 Taxman 378 (SC)

far as the assessee was concerned. It is in this backdrop that the Supreme Court observed that no useful purpose would be served in proceeding with the appeals on the other questions, when the assessee could not be taxed because of the principle of mutuality. Hence, from the judgment of the Supreme Court it is clear that the question as to whether interest earned on fixed deposits made by an assessee out of surplus funds would or would not fall within the purview of the principle of mutuality has not been adjudicated upon. The judgment of the Supreme Court must be construed as it stands. The observation of the Supreme Court was that no useful purpose would be served in proceeding with the appeals on the other questions. That was because as between the assessee and the Revenue in that case, the finding of the High Court that the doctrine of mutuality applied to the income earned by the assessee from letting out of the rooms to the members of the assessee had not been challenged in appeal.

22. On behalf of the assessee, Counsel relied upon the ***Commentary on Income-tax by Sampath Iyengar***[12] where, after adverting to the judgment of the Supreme Court in Cawnpore Club, the author has concluded that, "the issue can now be treated as finally resolved in favour of taxpayer". Reliance was also sought to be placed on a judgment of the Hyderabad Bench of the Tribunal in ***Fateh***

12 (10th Editiion Volume 8 Page 111)

Maidan Club Vs. Asstt. Commissioner of Income Tax[13]. The judgment of the Tribunal was sought to be relied upon since it contains an extract of the questions which were referred to the High Court at Allahabad from whose decision the judgment of the Supreme Court in Cawnpore Club emanated. Counsel submitted that two questions were referred for the decision of the High Court; the first being the exigibility to tax of the income of the club from letting out of rooms vis-a-vis the principles of mutuality and the second as to whether interest earned on fixed deposits and dividend was exempt on the principles of mutuality. The submission which was urged was that since both the issues were dealt with in the judgment of the High Court, they arose in the appeal before the Supreme Court and the judgment of the Supreme Court must, therefore, be regarded as concluding the question as to whether interest on fixed deposits would be within the fold of the principle of mutuality.

23. We are of the view that as a High Court, it is our bounden duty to read the judgment of the Supreme Court as it stands and not with reference to the underlying decision of the High Court of Allahabad, which has been quoted in the decision of the Income Tax Appellate Tribunal. The judgment of the Supreme Court makes it abundantly clear that since there was no challenge by the Revenue to

13 (2003) 81 TTJ (Hyd) 831

the finding on the principle of mutuality qua the income earned from letting out of the rooms to the members of the club, the Supreme Court was of the view that no useful purpose would be served in pursuing the other questions. The other questions have, therefore, not been adjudicated by the Supreme Court.

24. A decision of the Supreme Court becomes a precedent under Article 141 of the Constitution, when a question is directly raised and considered. The decision becomes a law declared where the question is actually adjudicated upon (***Tika Ram Vs.State of U.P.***)[14] The decision in Cawnpore Club does not actually decide upon the issue as regards the exigibility to tax of the interest received on surplus income invested in fixed deposits.

25. In order to fulfill the requirement of mutuality, a mutual association has to establish, as an essential requirement, the identity between participators and contributors to the fund. However, the fact that an Association satisfies the norm of mutuality in respect of the receipts of contributions from its members does not necessarily lead to the conclusion that every activity of the Association satisfies the test of mutuality. An Association may engage in activities which can be described as mutual and in other activities which are not mutual. The

14 (2009) 12 SCALE 349

Gujarat High Court recognized this in its decision in Sports Club of Gujarat (supra). Adverting to the decision in Commissioner of Income Tax V/s. Madras Race Club, the Court noted that the application of the principle of mutuality is not destroyed by the presence of transactions which are non-mutual in character. However, in such a case, the principle of mutuality has to be confined to transactions with members possessing the essential character of mutuality. The two activities can in appropriate cases be separated and the profits derived from transactions which do not fulfill the requirements of mutuality can be brought to tax.

26. The assessee in the present case utilizes its surplus funds for investment in fixed deposits with Banks. The interest that is generated on the investment of such funds is not income which is received from the members of the assessee but from third parties such as the banks with whom the funds are invested. Section 35(1) of the Bombay Public Trust Act, 1950 provides that where the trust property consists of money and which cannot be applied immediately or at an early date to the purposes of the public trust, the trustees shall be bound to deposit the money, notwithstanding anything contained in the instrument of the trust in a Scheduled Bank, in a Postal Savings Bank or in a Cooperative Bank approved by the State Government or to invest in public securities. What sub-section (1) of Section 35 mandates is that

moneys which are not required to be utilized immediately or at an early date for the purpose of the trust should be deposited in one of the forms which the Legislature has considered to be safe to protect the Trust. Section 35(1) in any case does not contain a mandate that moneys will have to be invested in a fixed deposit. Where moneys are invested in fixed deposits of Banks, the interest that is received on a deposit does not possess the same character of mutuality as the surplus funds derived by the assessee from the contributions of its members. The principle of mutuality applies to surplus funds generated from the contribution of members for the reason that the funds are contributed by the members of the Society and there is an identity between the contributors and the participators in the fund. The decision to invest the funds of the Association in Bank fixed deposits is a prudent commercial decision motivated by the desire to earn interest that would not be available on moneys maintained in ordinary, current or savings accounts. Such interest does not fulfill the requirement of mutuality. While investing the funds with a Bank or a Financial Institution, the assessee assumes the character of a customer of the bank or institution and the relationship that is engendered is that between a banker and its customer. The fact that the funds which are invested have their source in the contribution by the members of the assessee cannot be dispositive of the nature of the receipt obtained by the assessee on account of the interest payments on the deposits made. In determining the exigibility

to tax of receipts on account of interest, it is the character of the receipt as interest that must play a determinative role. A payment on account of interest by the bank or a party with whom the deposit is placed is an arms length transaction with a third party. The recompense which is received by the assessee by and as a result of the transaction does not fulfill the condition of mutuality to which the contributions received from the members of the assessee are subject.

27. We have adverted to several decisions of the High Courts which have considered the issue which has fallen for determination in these proceedings. Some of these decisions may undoubtedly possess a factual background on which there may not be complete identity with the facts of another case. The quest for complete identity is an illusion. The Court must be guided by the basic underlying principle which will guide the determination of the case. We are in agreement with the principle that is enunciated by the Karnataka High Court in I.T.I. Employees that the principle of mutuality would cover the surplus which accrues to a mutual association out of the contribution received by it from its members. The principle would have no application in case of surplus received from non-members. In a similar way, a deposit made with a bank for earning interest by way of income will not fulfill the requirement of mutuality. As the Karnataka High Court observed in its subsequent decision in the Bangalore Club, such a deposit implicates

a relationship between a banker and a customer, to which the principle of mutuality would not apply. The Madras High Court in the Madras Gymkhana Club emphasized the distinction between those activities of a mutual association which fulfill the norm of mutuality and those which do not. The mere fact that an Association exists for the mutual interest of its members would not result in the conclusion that all its activities, including those which involve financial transactions of the deposit of surplus funds for earning interest, also partake of the same character and nature. The judgment of the Madras High Court, has considered all the three judgments of the Karnataka High Court including the judgment in Canara Bank which struck a divergent note. Having given our careful consideration to the judgment of the Karnataka High Court in Canara Bank, we must express our reservations. The Madras High Court in Madras Gymkhana Club confined the decision in Canara Bank to the special facts as they appear in that case. The Karnataka High Court, while dealing with the issue in the Canara Bank placed a great deal of emphasis on the source of funds of the assessee. The High Court clarified that it was making it clear that its conclusion 'is based on the source of funds of the assessee during the two relevant years'. With respect, it must be pointed out that the mere fact that the funds which are invested in a fixed deposit with the bank are funds which originated from the contributions made by the members of the assessee cannot conclude the question as regards the

taxability of the receipts on account of interest obtained from the investment of these funds. These receipts must partake of the character of income from other sources and would be exigible to tax.

28. At this stage, it would be necessary for the Court to advert to a recent judgment of the Supreme Court ***Totgar's Cooperative Sale Society Limited V/s. Income-Tax Officer***[15]. In that case, the issue before the Supreme Court related to the deduction under Section 80P. The Supreme Court dealt with interest which had accrued on funds which were not required immediately by the assessee which was a cooperative credit society, for the purposes of its business and which came to be invested in specified securities as investment. The assessee had contended before the Supreme Court that under the provisions of the Karnataka Cooperative Societies Act, 1959, a statutory obligation was imposed on cooperative credit societies to invest their surplus funds in specified securities and the submission was that in view of the statutory obligation, income derived from short-term deposits and securities must be considered as income derived from business activities. The assessee marketed the produce of its members whose sale proceeds were at times retained by the assessee and the Court was concerned with the tax treatment of that amount. The Supreme Court held that such interest income would fall within the category of income from other sources and that it was correctly held to be taxable under

15 (2010) 322 ITR 283 (SC)

Section 56 by the Assessing Officer. In adverting to the judgment in the case of Totgar's Cooperative Sale Society, we must note that the principle of mutuality as such did not arise for consideration before the Supreme Court in that case. The submission that funds not immediately required for business were invested in specified securities / deposits under a statutory obligation and the receipt on account of interest would not constitute income from other sources was a specific issue which was raised before the Supreme Court. The Supreme Court held that such interest would fall for taxation as income from other sources.

29. A Division Bench of this Court in ***Sind Co-operative Society V/s. Income-Tax Officer***[16] considered whether transfer fees received by a Cooperative Housing Society from an incoming member were not liable to tax on the ground of mutuality. The transfer fees were to be paid by an Applicant for membership. The Court noted that the transfer fees could be appropriated only if the transferee is admitted to membership. In this context, the Division Bench observed that the fact that the proposed transferee may make the payment in advance was by itself not relevant since the amount could be appropriated only on the transferee being admitted as a member of the Society. If the member was not admitted, the transfer fee was refundable. The transfer fee was regarded as having no element of trading or

16 (2009) 317 ITR 47 (Bom)

commerciality and met the requirements of mutuality. In Sind Cooperative Housing Society, the issue which fell for consideration before the Division Bench was, therefore, distinct and is not the same as what has fallen for consideration in the second limb of the questions raised in this appeal by the Revenue.

For all these reasons, the second question of law as formulated would have to be answered in favour of the Revenue and against the assessee.

30. In so far as the taxability of other deposits and interest on income-tax refunds is concerned, we find from a reading of the order of the Tribunal that this issue has not been specifically dealt with or considered. Hence, we are of the view that it would be fair to permit the parties to urge all appropriate submissions before the Tribunal. We, accordingly restore the question of the taxability of other deposits and income-tax refunds for decision by the Tribunal afresh.

31. For all the aforesaid reasons, the appeal is disposed of. There shall be no order as to costs.

(J.P. Devadhar, J.) (Dr.D.Y. Chandrachud, J.)