

# **BOMBAY HIGH COURT**

Ismailia Grain Merchants Association Ltd

Vs.

Commissioner of Income Tax Bombay City

Income-tax Ref. No 47 of 1954

(Chagla, C.J. and Tendolkar, J.)

23.02.1955

## **JUDGMENT**

### **Chagla, C.J.**

1. The assessee is a private company limited by guarantee and it was incorporated on the 31st August 1944. Before the incorporation the Association had passed a certain resolution and that resolution was that after rationing week 56 and since 57th week, Mobadla at the rate of 8 annas per bag is to be collected from every rationing shop and for the shops which have registered less than 1,000 units on rationing cards Mobadla at the rate of 4 annas per bag is to be charged. Out of the proceeds of the Mobadla thus collected as above 25 p.c. will be utilised towards office expenses and charity and the balance of 75 p.c. will be distributed amongst members as Mobadla. Therefore, briefly, the scheme was this. It was not possible for all members of the Association to get a ration card. The Association used its good office to get ration cards for some of its members. As these members benefited by obtaining ration cards and other members were without ration cards, those who obtained ration cards were made to compensate those who had not, and the scale of compensation was laid down. The contention of the Income-tax authorities was that the surplus of 25 p.c. after legitimate deductions was the income of the assessee which was liable to tax. The assessee contested this position and has now asked the Tribunal to refer the question to us whether this surplus constitutes income.

2. Mr. Pandit's contention is that this is a mutual association and income arising to a mutual association is not subject to tax. What we have to consider is whether it is a mutual association according to the test laid down by various authorities. The reason why the income of a mutual association is not liable to tax is that a person cannot make profit out of himself and therefore the test of mutuality is only satisfied when the income is derived from the contribution of all the members and the income or part of it is spent for the benefit of all the members; in other words, there must be an identity between the contributors of the fund and the participators in that fund.

Unless and until such an identity is established the case would not fall within the principle of, mutuality. If the Association is not mutual then the income of the Association is derived from some of the members. There is nothing in law to prevent an association doing business with some of its members, in which case the income of that business would be liable to tax because the identity is not established between the association as a whole and the members who do business with it. This principle is fairly clear and the only question is the application of the principle to the facts of each case.

3. This principle was clearly enunciated by the Supreme Court in *Commissioner of Income Tax v. Royal Western India Turf Club Ltd<sup>1</sup>*, to which Mr. Pandit has referred. In that case they referred with approval to the well known case of *Styles v. New York Life Insurance Co<sup>2</sup>*, and at p. 559 (of ITR), they refer to the observations of Lord Macmillan in that case:

"The cardinal requirement is that all contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between the contributors and the participators. If this requirement is satisfied, the particular form which the association takes is immaterial."

And at p. 560 (of ITR), they point out what the true principle is:

"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."

The Supreme Court has examined various decisions and the view it has taken is the view which is in conformity with the majority judgment in the Styles case.

4. Mr. Pandit has also referred to another decision of the Allahabad High Court which is reported in *Chamber of Commerce, Hapur v. Commissioner of Income Tax, United Provinces<sup>3</sup>*, In that case the assessee was the Chamber of Commerce and its income was derived from admission fees and annual subscription of members, registration fees for grain pits and commission on purchase and sale on forward delivery contracts entered into between members inter se or between outsiders or between an outsider and a member. The Income-tax authorities held that the income from admission fees and annual subscription was exempt from tax, but assessed the company in respect of income from commissions and registration fees, and the question arose with regard to the income from this latter source. The judgment at p. 409 (of ITR), makes it clear that the decision of the Court turned on a concession made by the Income-tax Commissioner and the learned Judges held that the Income-tax Commissioner was bound by that concession. The concession was that the income from commission and registration fees was not income from business, and Mr. Justice Collister in delivering the judgment points out that he refrained from

expressing any view as to whether the Income-tax Commissioner was right in conceding that these payments were not income from business, for he was clearly of opinion that the department was bound by that admission. The Income-tax Officer and the Assistant Commissioner of Income-tax both held that these payments were income from business and it was on that finding that the assessee asked the Income-tax Commissioner to refer the question to the High Court. But as just pointed out, the learned Judges took the view that inasmuch as the Income-tax Commissioner had accepted the position that the income was not from business he was bound by that admission, and it was on that

<sup>1</sup>(1953) 24 ITR 551

<sup>3</sup>(1936) 4 ITR 397: AIR 1936 All 764

<sup>2</sup>(1889) 2 Tax Cas 460

ground that the learned Judges could not accept the view that if this was not income from business but from any other source that the assessee was held entitled to exemption from tax.

5. The last judgment on which reliance is placed is the judgment of the English Court which is referred to in the Supreme Court judgment, and that is *National Association of Local Government Officers v. Watkins (H. M. Inspector of Taxes<sup>4</sup>)*. Now, the facts there are very significant. The assessee was an unregistered trade union and it ran a holiday camp to provide cheap holiday facilities for its members, their wives, families and friends. In the year in question bookings were also accepted from non-members. The profits made by running this camp were credited to the general funds of the association and the funds enured for the benefit of the members of the association as a whole and not of the camp users only, and the question was whether income received from this camp was liable to tax, and the English Court held that the only income which was liable to tax was profits made by the association from non-members. Mr. Pandit relies on this case for the proposition that although the profits from the camp were made by contribution made by only some of the members and the profits were spent on all the members and thereby there was no identity between the contributors and the participators, still the English Court held that it was a mutual association. Now, the fallacy underlying this argument is that although only a few members of the association could avail themselves of, the benefit of the holiday camp and contribute to the profits, every member had a right to go to the camp and contribute to the profits. Therefore, for the purpose of mutuality it may not be necessary that contribution in fact should be made by every member, but every member should have the right to make the contribution, and Mr. Justice Finlay points out at p. 506 that in a club which gives various facilities some members may avail themselves of some facility and others may avail themselves of other facilities, from that it does not follow that all the facilities were not available to the members or the members could not participate in all the facilities.

6. Therefore, the test being simple and well established, let us apply it to the facts of this case. The fund which is sought to be taxed is contributed by only those members of the association who have received ration cards. Therefore all the members have not contributed to this fund. Let us ask ourselves the question whether even though all members have not contributed to this fund, did all the members have a right to contribute to this fund and if they so intended could they have contributed to this fund? The answer must obviously be in the negative because the whole object

of this association was to get money from a section which had benefited by getting ration cards and compensate the other section which had not received the ration cards. Therefore, the right, or in this case the obligation, to contribute to the fund rested only upon a section of the members. Therefore there was no identity between the contributors to the fund and those who participated in the fund or were beneficiaries of the fund.

7. It is then suggested by Mr. Pandit that the association merely acted as an intermediary and that it took the money from the persons who had obtained the ration cards and gave that money to those who were without ration cards. But if in acting as an intermediary the association got paid for its services, then clearly what it received and what it was paid constituted income within the meaning of the Income-tax Act. Undoubtedly, the

<sup>4</sup>(1934) 18 Tax Cas 499

association did do some work in possibly getting the ration cards and collecting the money from those members who had obtained ration cards. But inasmuch as it was paid for this service and the payment was only by a section of the members and not by all the members, the surplus receipt in the hands of the association constituted income within the meaning of the Income-tax Act.

8. It is then urged by Mr. Pandit that the fund in the hands of the association was not at its free disposal. He points out that 75 p.c. had to be distributed among the members who did not receive the ration cards and after deducting the expenditure the balance had to be spent on charity. Now, it is difficult to understand that argument. It makes no difference to the income of a person if that income has attached to it certain legal obligation. Trustees who receive income with an obligation to spend it according to the terms of the trust are still liable to pay tax. A trustee is only exempt when the money he has to spend is to be spent for charitable purposes within the meaning of the Income-tax Act, and the assessee has never contended that the income which it received was exempt on the ground that it was spent for charitable purposes. In our opinion, therefore the Tribunal was right when it came to the conclusion that the surplus in the hands of the assessee company was liable to tax as its income.

9. We would therefore answer the question submitted to us in the affirmative.

10. On the question of costs, Mr. Pandit urges that the Income-tax authorities assessed the assessee under Section 10 on the ground that the surplus constituted income from business. The Tribunal has taken the view that Section 10 has no application, but the assessee is liable to be taxed under Section 12 as income from other sources. We do not understand what difference does it make whether the assessee is liable to pay tax under Section 10 or under Section 12, and the only question that has been referred to us is whether this constitutes income which is liable to be taxed. In our opinion the assessee must pay the costs of the reference.

Answer in affirmative.