Wankaner Jain Social Welfare Society Vs Commissioner of Income Tax

Court: Madras High Court

Date of Decision: Sept. 11, 2002

Acts Referred: Income Tax Act, 1961 â€" Section 37(1), 4

Citation: (2003) 181 CTR 351

Hon'ble Judges: R. Jayasimha Babu, J; K. Raviraja Pandian, J

Bench: Division Bench

Advocate: Anitha Sumanth, for the Appellant; T.C.A. Ramanujam, for the Respondent

Judgement

@JUDGMENTTAG-ORDER

R. Jayasimha Babu, J.
The memorandum of association dt. 14th Nov., 1981, of the assessee Wankaner Jain Social Welfare Society sets

out the objects of the society. These objects inter alia are to create and cultivate the habit of saving and thrift among the members of the society; to

help by way of loan or other assistance members who are in bona fide need to help for the purpose of promotion of business, trade, profession,

industry, agriculture, etc. The rules and regulations of the society make it compulsory for every member to participate in the scheme of deposit,

which is provided for in Rule 50(c). The deposit is to be a minimum of 50 paise and multiples thereof per working day. The members may seek

loans. Loans are regulated by Rule 52. The loan application is to be considered by the loan committee, only when a member has furnished two

sureties. The decision of the land committee will be final and binding on the applicants for loans. In the case of ladies who are not earning members,

loan is limited to 90 per cent of the deposit. The period of the loan will be from a minimum of one month and upto a maximum of twelve months. If

the amount of loan sought is within fifty per cent of the deposit standing to the credit of the applicant for the loan, such loan application is not to be

rejected if that member is not in default in the matter of payment for the cumulative deposit. Rule 60 of the rules provides that in case the society is

to be wound up, the property and funds of the society remaining, after full satisfaction of the liabilities of the society, may be distributed among the

members of the society in such manner as the general body of the society may in its absolute discretion decide, or it may be transferred or paid to

some other institution with similar aims and objects.

2. Rule 57 deals with the funds of the society and provides that the income, profit and funds of the society shall be applied solely towards the

promotion and the objects of the society and a portion of the income of the society may be paid directly or indirectly by way of bonus or otherwise

by way of profit to the promoters, founder-members and members of the society. The managing committee shall decide on the quantum, mode and

manner of distribution of such profits.

3. That Rule 57 was amended on 1st July, 1990, after the general body of the , members resolved to incorporate a new Rule 57(b). The rule

provides that every year the society shall pay out of its receipts all such expenditure as are required for the management of the society including

salary, bonus, gratuity and other amenities due to the employees, interest on deposits received by the society and other outgoings, which are

necessary for the incidental to the transactions of the society. That new sub-rule also provides that the net surplus remaining after meeting the

aforesaid expenses and disbursements shall be distributed only among those who have entered into transactions with the society and have

contributed to the profits.

4. For the asst. yrs. 1984-85 to 1990-91, the assessee''s claim that it was a mutual benefit society which did not make any profit and, therefore,

no Income Tax was leviable was rejected by the AO as also by the appellate authority and the Tribunal. For the asst. yr. 1991-92, the claim was

allowed.

5. At the instance of the assessee, the following questions have been referred :

1. Whether, on the facts and in the circumstances of the case the Tribunal was right in law in holding that the principle of mutuality is not satisfied in

this case.

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in law in holding that income arises only from those who have

taken loans and hence the right to receive a portion of the income by those who have not taken the loans but have made deposits to the assessee

vitiates the principle of mutuality.

6. For the asst. yrs. 1989-90 to 1991-92 a further question has been referred at the assessee''s instance, viz., as to whether the Tribunal is right in

law in holding that the amended Rule 57(b) would be operative only from the asst. yr. 1991-92 and not from 1990-91 in view of the fact that the

amendment will come into force only after its approval by the general body of the association.

7. For the asst. yrs. 1989-90 to 1991-92, at the instance of the Revenue, two questions have been referred, viz.,

1. Whether the Tribunal was right in law in allowing the assessee''s claim for deduction of interest on the deposits to the members of the society

for the asst. yrs. 1989-90 to 1991-92.

2. Whether the Tribunal was right in law and had valid materials to hold that the assessee had satisfied the test of mutuality for the asst. yr. 1991-

92 and accordingly its income is eligible for exemption for the asst. yr. 1991-92 on that basis.

8. Learned counsel for the assessee submitted that the assessee satisfied all the tests of mutuality laid down by the Supreme Court in the case of

Commissioner of Income Tax,Madras Vs. Kumbakonam Mutual Benefit Fund Ltd., . It was pointed out by the learned counsel that unlike in the

case considered by the Supreme Court, in this case, the members were duty-bound to make a deposit and, therefore, it makes a vital difference to

the outcome regarding the taxability or otherwise of the interest income derived by the assessee.

9. In the case of CIT v. Kumbakonam Mutual Benefit Fund, a three Judge Bench of the apex Court considered in depth the English decision in the

case of Styles v. New York Life Insurance Corporate (1889) 2 Tax Cases 460. It affirmed the principle laid down in the Style''s case by a

majority of the House of Lords and set aside the judgment of the High Court which was in appeal before it by holding that the judgment of the High

Court was not consistent with the decision in Style''s case. The Court went on to observe that in the Style''s case it had been noticed that all

participators must be contributors to the common fund and not that all participants must be entitled to contribute and further that the essence of

mutuality lies in the ""return of what one has contributed to a common fund"".

10. The working of the assessee before the Court in that case was also described. The assessee therein obtained recurring deposits contributed

monthly by it''s members for a fixed number of months as stipulated at the end of which a fixed amount was returned to them according to

published tables. Those recurring deposits constituted the main source of funds of the assessee for advancing loans. The loans were to be

advanced only to members who had also to offer substantial security therefor.

11. After considering the law in Style''s case (supra) in relation to the facts of the case before it, the apex Court concluded thus :

A shareholder in the assessee-company is entitled to participate in the profits without contributing to the funds of the company by taking loans. He

is entitled to receive his dividend as long as he holds a share. He has not to fulfil any other condition. His position is in noway different from a

shareholder in a banking company, limited by shares. Indeed, the position of the assessee is no different from an ordinary bank except that it lends

money to and receives deposits from its shareholders. This does not by itself make its income any the less income from business within Section 10

of the Indian IT Act.

12. The case of Styles, decided by the House of Lords in 1889 concerned a mutual assurance company. Though Lord Halsbury who was one of

the Judges who heard that case held that the real nature of the transaction before the House was accurately described as being in the nature of a

bet on the duration of life and observed that it would make no difference whether the members of the association made bets upon each other''s

lives or on the lives of people outside their own circle and that an ordinary betting man''s gains would be assessable and they would not be the less

so if his bets were confined to his own club or to an association whose rules excluded any bet except with a member of their own body, the other

learned Judges, who heard the case held that the persons who agree to contribute to a common fund for mutual insurance certainly would not, in

ordinary parlance, be regarded as carrying on a trade or vocation for the purpose of earning profit. The profit so called in that case, it was found,

arose out of the premiums which the members were required to pay being in excess of what is necessary to provide for the requisite payments to

be made upon the deaths of members and such a result came about either from the contributions having, owning to erroneous estimation or over-

caution, been originally fixed at a higher rate than was necessary or from the death-rate being lower than was anticipated.

13. Lord Herschell in his speech after noticing this position said, ""Can it be properly said that, under these circumstances, the association of mutual

insurers has earned a profit ? The members contribute for a common object to a fund which is their common property; it turns out that they have

contributed more than is needed, and, therefore, more than ought to have been contributed by them, for this object, and accordingly their next

contribution is reduced by an amount equal to their proportion of this excess. I am at a loss to see how this can be considered as a ""profit"" arising

or accruing to them from a trade or vocation which they carry on. It is true the alternative is allowed them of leaving the excess in the common

fund, and so increasing their representative''s claim upon it in case of death, but I cannot think that this makes any difference"". Lord Macnaghten in

his speech observed that the company (so far as regards the participating policy-holders) was not formed for the purpose of carrying on a business

having for its object the acquisition of gain at least by the company itself and, therefore, that the mutual insurance was carried on through the

medium of a company was immaterial. The essence of the transaction was described by the learned Judge thus :

Certain persons agree to insure their lives among themselves on the principle of mutual insurance. They take care to admit none but healthy lives.

They contribute according to rates fixed by approved tables, and they invite other persons to come in and join them by insuring their lives on similar

terms. The rates fixed by the tables are taken as being sufficient to provide for expenses to meet liabilities and to leave a margin for contingencies.

What is to become of the surplus is everything goes right ? The practice is to take an account every year of assets and liabilities, and to give the

insured the benefit of the surpluses, either by way of reduction of premium or by way of addition to the sum insured.

It was further observed, ""I do not understand how persons contributing to a common fund in pursuance of a scheme for their mutual benefit, having

no dealings or relations with any outside body, can be said to have made a profit when they find that they have overcharged themselves, and that

some portion of their contributions may be safely refunded.

14. The law laid down in the case of Styles (supra) was in the context of a fact situation where there was complete identity between the persons

who contributed to the earning of the so-called profit and the persons entitled to participate in that profit. The Supreme Court in the case of

Kumbakonam Mutual Benefit Fund (supra) approved of that law and limited it''s application only to situations where the mutuality was clearly

established by establishing the complete identity as between the contributor and the participator in the common fund. The fund which the Court

took into account in that case was not the fund made available for being used as capital for the purpose of earning the income but was the income

itself which was available for being distributed. The identity was required to be established in relation to that income as regards those contributing

to that income and those participating in the distribution of that income.

15. Here, though a member is of necessity also a depositor he is not required to be a borrower. That is wholly optional. The income of the fund is

by way of interest and such interest is received only from those who borrow from it. The fact that the money that is lent comes out of the deposits

made by the members who have borrowed as also the deposits made by members who have not chosen to raise any loan will not make any

difference so far as the need for establishing the identity between the contributor and participator vis-a-vis the interest income is concerned.

16. The point of distinction sought to be made by the learned counsel is really not a factor which in anyway affects the decision as to whether or

not in the circumstances mutuality exists. Though the Supreme Court had observed that the shareholder in the case before it was not required to

fulfil any other condition, the fact that the member here fulfils the condition of being a depositor would not by itself make him a contributor to the

interest income which the assessee had earned by lending monies to such of those members who had sought loans from it.

17. To the extent the income received by the assessee by way of interest on loans is available for being distributed among all the members including

those who had not borrowed monies, the identity between contributor and participant is lost.

18. We are, with great respect, unable to subscribe to the view taken in the case of Commissioner of Income Tax Vs. Nataraj Finance

Corporation, and Commissioner of Income Tax Vs. Merchant Navy Club, , wherein it was held that it is enough to show that a person had a right

to be a contributor even though he did not contribute. The identification between contributor and participant is a mandatory as held by the

Supreme Court in the case of Kumbakonam Mutual Benefit Fund (supra).

19. The further submission made by the learned counsel that Rule 57(b) should be given retrospective effect is not an argument which can be

accepted. The unincorporated body of persons, having transacted business for many years, cannot after assessment had been made, purport to

alter retrospectively the terms on which they had come together, by seeking to introduce a new clause for the sole purpose of avoiding liability to

tax. That amendment can only have prospective operation and not retrospective operation.

20. The question referred to us at the instance of the assessee, therefore, are required to be and are answered against the assessee and in favour of

the Revenue.

21. So far as the question referred at the instance of the Revenue are concerned, these must be answered in favour of the assessee and against the

Revenue. The interest that the assessee had paid would be an item of expenditure which the assessee was entitled to deduct in computing its

profits. After the introduction or Rule 57(b) there was complete identity between contributor and participant and the doctrine of mutuality was

attracted in the asst. yr. 1991-92. The questions referred at the instance of the Revenue are answered against the Revenue and in favour of the

assessee.