

**SEMINAR ON**

**Concept of Charity and Mutuality**

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**At**

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## Charity & Mutuality

1. The principle of mutuality is based on the principle that an organization cannot derive income from itself, meaning that an organizations' income consists only of funds derived from external sources. Therefore when a number of persons(i.e., members of a club, association or organization) contribute to a common fund which is created and controlled by those persons for a common purpose, any surplus arising therefrom, for the common purpose, will not be deemed to be income. This is known as principle of mutuality as one cannot make an income from oneself. The mutual organizations are carried on the benefit of members collectively. Thus, the profits are distributed or utilized by the members collectively. The principle of mutuality was explained in simple terms by Madras High Court in the case of CIT Vs Madras Race Club(1976) 105 ITR 433(Mad) as follows:-

In considering the case for exemption of the subscriptions collected from the members of the application on the principle of mutuality it is necessary to bear in mind two concepts. The first concept is that the principle of mutuality is based on the doctrine that no person can make a profit out of himself. To take a common instance, supposing a dozen persons' gather together and agree to purchase certain commodities in bulk and distribute them among themselves in accordance with their individual requirements, they may collect a certain amount provisionally based on the anticipated price of the commodities to be purchased. If it ultimately happens that the commodities are available at a cheaper price so that at the end of the distribution of the commodities among themselves, a part of the original amount provisionally collected is repaid, then what is repaid cannot by any test be classified as income. This would represent savings and not income. The Income-tax Act seeks to tax income and not savings. If this principle is borne in mind, then it would be easier to understand the decisions rendered on this point. It may be seen that in the above instance there is no trading as such. The same legal position would apply even where the parties join together and meet their commercial requirements in a manner mutually beneficial to them. In such a case there may be a trade inter se ; but the trade is not one intended to bring in any profits. It is this aspect which is referred to by Lord Normand in *English and Scottish Joint Co-operative Wholesale Society*

*Ltd. v. Commissioner of Agricultural Income-tax* [1948] 16 ITR 270, 279 (PC):

"the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves."

On the same issue the following decisions are important:-

- i) *Styles Vs New York Life Insurance Company*(1889) 2 TC 460(HL)
- ii) *Jones Vs South West Lancashire Coal owners Association Ltd* (1927) 11 TC 790(HL)
- iii) *CIT Vs Royal Western India Turf Club Ltd* (1953) 24 ITR 551(SC)

## 2. Charity & Mutuality -whether can exist together

In case of a charitable organization, the primary condition is that the organization cannot distribute surplus amongst the members and the surplus is always for the benefit of public at large. In such a situation, it is always believed that charity and mutuality cannot go together. It is pertinent to refer to the decision of Australian Court decision in the case of *Coleambally Irrigation Mutual Co-operative Ltd Vs FCT*(2004) FCAFC 250 which ruled that the principle of mutuality did not apply because the organization's constitution prohibited the distribution of surplus fund to the members. However, even though charitable organization exists for the benefit of public at large, even if they are rendering services to the members, the principle of mutuality has been applied in several cases as would appear from discussion later on.

It has been time and again discussed in professional circles that charity and mutuality are contradictory and cannot go together. However, in a number of decisions where the organization has been enjoying the provisions of charity, Income has been exempted applying principles of mutuality . Infact the Central Board of Direct Taxes(CBDT) in its Circular NO 11/2008 dated 19-12-2008 has clarified as follows in Para 3.1 of the Circular:-

3.1 There are industry and trade associations who claim exemption from tax under section 11 on the ground that their

objects are for charitable purpose as these are covered under 'any other object of general public utility'. Under the principle of mutuality, if trading takes place between persons who are associated 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 the persons forming such association is not chargeable to tax. In such cases, there must be complete identity between the contributors and the participants. Therefore, *where industry or trade associations claim both to be charitable institutions as well as mutual organisations and their activities are restricted to contributions from and participation of only their members, these would not fall under the purview of the proviso to section 2(15) owing to the principle of mutuality.* However, if such organisations have dealings with non-members, their claim to be charitable organisations would now be governed by the additional conditions stipulated in the proviso to section 2(15).

In the case of CIT Vs Indian paper mills association (1994) 209 ITR 28(Cal) it was held that the right of members of the club regarding the disposal of the surplus at the time of dissolution of the club cannot nullify the principle of mutuality in as much as the participants themselves should decide how the surplus fund should be utilized. Moreover the court also noted that if at all this question can arise in the actual year of dissolution to see whether the surplus has been distributed in accordance with the objects or not.

Thus in such a situation even in case of a charitable organizations ,the principle of mutuality becomes applicable.

### 3. Mutuality-Identity between classes

The mutuality principle is dependent upon the existence of an identity between contributors to the fund and those who are entitled to participate in it. The identity required is not an identity between individuals, but an identity between classes , and all that is required is reasonable relationship between what a member contributes and the member's expected participation in the common fund. *Sydney Water Board Employees Credit Union Vs Federal commissioner of taxation(1973) 129 CLR 446*

### 4. What is Mutuality

Typically the following are the characteristics of a Mutuality organization:-

They are carried on for the benefit of members' collectively. They have members that share a common purpose. Those members are all entitled to participate in that common purpose. The main purpose for which the organization is established and is operated is the common purpose of the members and all the members contribute to a common fund that gives effect to the common purpose and all contributions are applied for the collective benefit of the members. The members contribute not with an idea to trade, but with an idea of rendering mutual help. The receipt in their hands is not really the profit, as no man can make a profit out of himself, just as he cannot enter into a trade or business with himself.

In this regard, the Apex court in the case of Commissioner of Income-tax Vs Royal Western India Turf Club(1953) 24 ITR 551(SC) held that

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".

*Styles'* case has recently been examined and explained by the Judicial Committee in *English & Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of Agricultural Income-tax, Assam'* [1948] AC 405; 16 ITR 270 After referring to various passages from the speeches of the different Law Lords in *Styles'* case Lord Normand, who delivered the judgment of the Board, summarized the grounds of the decision in *Styles'* case as follows:—

"From these quotations it appears that the exemption was based on

(1) the identity of the contributors to the fund and the recipients from the fund,

(2) the treatment of the company, though incorporated as a mere entity for the convenience of the members and policy holders in other words, as an instrument obedient to their mandate and

(3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves"

## 5. Types of Organizations

- i) Clubs
- ii) Trade Associations
- iii) Housing Society
- iv) Mutual benefit society
- v) Employees benefit society
- vi) Professional Associations
- vii) Kitty in modern day.
- viii) Chit fund
- ix) Association of persons for mutual help
- x) Puja Pandals

## 6. Impact of mutuality on income-Broad principles

The practical effect of the principle is that receipts derived from mutual dealings with an organization's members (mutual receipts) are excluded from the assessable income of the organization; expenses incurred to get mutual receipts are not deductible; receipts derived from trading with non-members and income from sources outside of the organization are treated as assessable income and the expenses directly related to the assessable income can be claimed as expenses.

## 7. Participators need not take surplus themselves

The participation envisaged in the principle of mutuality is not that the members should take the surplus to themselves. It is enough if they have the right of disposal over the same. (*See CIT Vs West Godavari District Rice Millers Association 150 ITR 394(AP)*). In the

said decision, the Hon'ble Court relied upon the decision of the Madras High Court in the case of CIT Vs Madras Race Club(1976) 105 ITR 433(Mad) wherein it was held as follows:-

"The memorandum and articles of association of a company represent the contract between the company and the members. It is only by virtue of their ownership of the surplus assets, if any, that the members had agreed to the clause that they would not take back the surplus, but allow it to be transferred to any similar entity. As they themselves are to deal with the surplus, if any, at the time of winding up, it cannot be said that they are not participators in the surplus. This clause is only a fetter in the manner of disposal. The participation envisaged in the principle of mutuality is not that the members should willy-nilly take the surplus to themselves. It is enough if they had a right of disposal over the surplus to show that they were the participators." (p. 434).

Moreover, the Madras High court quoted the English case of IRC Vs Eccentric Club Ltd (1925) 12 TC 657(HL) wherein it was provided clause 6 of the Memorandum that no member of the club in his character as such member was entitled to receive, directly or indirectly, any dividend, bonus or other profit out of such income or property of the club. On the winding up of the Club, the surplus if any was not to be distributed to the members but was to be given or transferred as the committee of management may determine. With all these features, it was held that the doctrine of mutuality would apply and the amount was not liable to be taxed.

Also in the aforesaid decisions it was held that it is well settled that the identity need not be necessarily of individuals because it is the identity of status or capacity which matters more.

8. Application of principle of mutuality is not destroyed on account of transaction with non-members

One extreme contention advanced on behalf of the revenue was that where a club had taxable income from trading or business activities, then there was no scope for the application of any principle of mutuality, even assuming that the subscriptions could be brought within the ambit of this principle. In *Carlisle and Silloth Golf Club v. Smith* [1912] 6 TC 48, 54, 55 (KB). there was a club, which was a *bona fide* members' club, for the purpose of recreation and other purposes incidental thereto. It took on lease from a railway company an open land which was utilized as a golf

club at a nominal rent on condition that the golf club was to be run there and that non-members would be allowed on payment of certain fixed amounts for the use of the golf course. There were enough visitors to avail themselves of this privilege. The revenue authorities sought to assess the entire profits or gains of the golf club consisting of receipts from members and non-members. The court held that in so far as the club engaged itself in granting facilities of playing golf to non-members, it was carrying on a trade or business, and the profit was liable to be assessed. As regards contributions from the members, the principle of mutuality was applied. With reference to the facilities afforded on receipt of "green fees" from non-members, Hamilton J. held as follows<sup>1</sup>:

"Now it seems to me that that constitutes engaging in the carrying on of an enterprise which is in itself outside the scope of the club and is distinct from the ordinary objects and activities of the club;....."

I think, therefore, that at the outset the club has, for considerations sufficient in its own view, annexed to its ordinary enterprise of a golf club the rendering of services systematically to strangers for the purpose of obtaining, among other advantages to itself the revenue that those strangers provide.....; it is a case it seems to me at the outset in which this aggregate of gentlemen, who may for practical purpose be treated as one person, annexed to their club for the purposes of recreation an enterprise which is separate from it and which results in pecuniary receipts to themselves."

This case, in our opinion, shows that the application of the principle of mutuality is not destroyed by the presence of transactions with, or profits derived from non-members. The said principle could apply to transactions with members. The maintenance of a combined account for all the transactions does not also affect the claim, as the way in which the accounts are kept is not conclusive in matters of taxation. The two activities can in appropriate cases be separated and the profits, if any, from the members, can be taken on the basis of the actuals from the accounts or, at any rate, by an estimate if it should become necessary. We are, therefore, unable to accept this part of the contention of the revenue. We are not shut out from considering the question of mutuality by virtue of (a) transactions with non-members or (b) maintenance of common accounts.

## 9. All the participators must be contributors to common fund

In the case of CIT Vs Kumbakonam Mutual Benefit Fund Ltd (1964) 53 ITR 241(SC), the Hon'ble Apex Court held that essence of mutuality lies in the return of what one has contributed to a common fund, and if profits are distributed as shareholders, the principle of mutuality is not satisfied. All the participators must be contributors to the common fund, mere entitlement to contribute will not suffice.

10. Receipts for various facilities extended by club to its members

Receipts for the various facilities extended by the clubs to its members, as part of usual privileges, advantages and conveniences, attached to the membership of the club, could not be said to be from "a trading activity" and the surplus-excess of receipts over expenditure- as a result of mutual arrangement could not be said to be "income" for the purposes of the Act. CIT Vs Bankipur Club Ltd 226 ITR 97(SC)

11. Annual value of club house -also exempt on mutuality principle

In the case of Chelmsford Club Ltd Vs CIT 243 ITR 89(SC), it was held that in addition to the surplus arising from the activities of the business of the club that was excluded from the levy of income-tax, even the annual value of the club house, as computed in Section 22 of the income-tax Act would be outside the purview of the levy of income-tax on principles of mutuality.

12. Principle of mutuality applies to what type of income?

Principle of mutuality applies to all non-commercial activities. As regards income from commercial ventures, the club or society would not be entitled to claim principles of mutuality in respect of adventures of commercial nature.

a) Sports Club of Gujarat Ltd Vs CIT 171 ITR 504(Guj)

Receipts from interest on bank deposit can be treated as exempt on principles of mutuality

b) CIT Vs Apsara Co-operative Housing Society Ltd 204 ITR 662(Cal)

Transfer fee realized from a newly inducted member in a co-operative housing society was eligible to be exempt on principles of mutuality. Transfer Charges, non-occupancy

charges were held to be exempt on principles of mutuality in the case of 402 ITR 670(SC). In the case of CIT Vs Apsara Co-operative Housing Society Ltd (1993) 204 ITR 662(Cal) it was held that the transfer fees charged by a cooperative housing society was exempt on account of mutuality and the principles which governed clubs as far as mutuality are concerned will equally govern co-operative housing society as well. See also ITO Vs Venkatesh Premises Co-operative society ltd (2018) 402 ITR 670(SC). The apex court case dealt with non-occupancy charges, transfer charges and common amenity fund charges.

13. Advertisement collected from members- taxable -Automobile association of Bengal Vs CIT, Calcutta(1968) 69 ITR 878(cal)- the principle of mutuality was held to be not applicable as the money was collected by the association from some of the members as advertisement charges but benefits came out of the same to the members not as advertisers but as members. Moreover, the advertisers got commercially benefitted.

14. Interest earned on surplus fund invested in fixed deposits- In the case of 350 ITR 509(SC), the question was whether or not interest earned by the assessee on the surplus funds invested in fixed deposit with the corporate member banks is exempt from levy of income-tax based on doctrine of mutuality? The apex Court held as follows:-

Before we evaluate the rival stands, it would be necessary to appreciate the general understanding of doctrine of mutuality. The principle relates to the notion that a person cannot make a profit from himself. An amount received from oneself is not regarded as income and is therefore not subject to tax; only the income which comes within the definition of Section 2(24) of the Act is subject to tax (income from business involving the doctrine of mutuality is denied exemption only in special cases covered under clause (vii) of Section 2(24) of the Act). The concept of mutuality has been extended to defined groups of people who contribute to a common fund, controlled by the group, for a common benefit. Any amount surplus to that needed to pursue the common purpose is said to be simply an increase of the common fund and as such neither considered income nor taxable. Over time, groups which have been considered to have mutual income have included corporate bodies, clubs, friendly societies, credit unions, automobile

associations, insurance companies and finance organizations. Mutuality is not a form of organization, even if the participants are often called members. Any organization can have mutual activities. A common feature of mutual organizations in general and of licensed clubs in particular, is that participants usually do not have property rights to their share in the common fund, nor can they sell their share. And when they cease to be members, they lose their right to participate without receiving a financial benefit from the surrender of their membership. A further feature of licensed clubs is that there are both membership fees and, where prices charged for club services are greater than their cost, additional contributions. It is these kinds of prices and/or additional contributions which constitute mutual income.

The Apex Court in a detailed case held that the income was not exempt on the principles of mutuality.

In the case of CIT Vs Common Effluent Treatment Plant(2010) 328 ITR 362(Bom), the issue of taxability or otherwise of interest on fixed deposit with banks was discussed threadbare and the court was not inclined to follow the decisions of Karnataka High Court in the case of Canara Bank Golden Jubilee Staff Welfare Fund Vs Dy CIT(2009) 308 ITR 202(SC). Later on the decision in the case of Common Effluent has been approved by the Apex Court in ITO Vs Venkatesh Premises Co-operative society ltd (2018) 402 ITR 670(SC).

Interest on fixed deposit with bank was exible to tax and could not be made exempt on the principles of mutuality – Sports Club of Gujarat ltd vs CIT(1988) 171 ITR 504(Guj). See also (1995) 211 ITR 379(Gujarat)

15. Even though facilities were provided to members including general public-income was held as exempt -DIT(Exemptions) Vs Chembur Gymkhana(2013) 346 ITR 86(Bom)

In the said case it was held that notwithstanding the fact that the facilities of the club were being provided to members including general public, the activities were covered as advancement of object of general public utility and hence the income was exempt u/s 2(15) of the Act.

16. Bombay Presidency Golf club Ltd Vs DIT(Exemptions) (2012) 23 taxmann.com 319(Mum).

Where all the activities of the assessee club towards its objects of promotion of game and other ancillary activities carried were only incidental to said game only, registration already granted u/s 12AA cannot be cancelled. Even otherwise, principle of mutuality is applicable. CBDT Circular No 11/2008 followed.

Also ITO€-1, Kolkata Vs Indian leather Products Association (2015) 64 taxmann.com 406(Kolkata-Tribunal)

17. Delhi Stock Exchange Association Ltd Vs CIT Delhi (1961) 41 ITR 495(SC)

In this case the apex court held that the entrance fee received from trading members was not exempt on account of principle of mutuality as the body of trading members who had paid the entrance fees and the shareholders among whom the profits of the company were distributed were not identical and the element of mutuality was lacking.

18. In the case of The English and Scottish Joint Co-operative Wholesale Society Ltd Vs Commissioner of Agricultural Income-tax, Assam (1948) 16 ITR 270(PC), it was held that the principle of 'styles' case cannot be applied to an association, society or company which grows produce on its own land or manufactures goods in its own factories, using either its own capital or capital borrowed whether from its members or from others and sells its produce or goods to its members exclusively.

No matter who the purchasers may be, if the society sells the tea grown and manufactured by it at a price which exceeds the cost of producing it and rendering it fit for sale, it has earned profits which are, subject to the provisions of taxing act, taxable profits.

The reason for taking such a stand that the society was formed under the Industrial and Provident Societies Act, 1893 which contemplated that the society registered under the said act will be a profit-making concern. The Court noted that when the constitution, rules and business practices of the appellant society so closely conform to the pattern of an ordinary profit-making concern, how can it plausibly be maintained that no profits can result?

Thus, a commercial venture in order to make profits cannot be treated as exempt on account of principles of mutuality.

19. In the famous case of CIT, Bombay City Vs The Royal Western India Turf Club Ltd (1953) 24 ITR 551(SC), the constitution bench of the Apex Court dealt with extensively the principles of mutuality. The Hon'ble court noted the following important points:-

- i) The objects of the Company are inter alia, to carry on the business of a Race course company in all its branches and to carry on the business of hotel-keepers , tavern-keepers, licensed victualler and refreshment purveyors. The court noted that although this circumstance may not be decisive , it cannot at the same time be overlooked altogether. It has to be noted as one of the material facts.
- ii) There is no mutual dealing between the members inter se in the nature of mutual insurance as was in the styles case and the principles of mutuality cannot be applied to an incorporated company which carries on business of horse racing and realizes money from the members and from the non-members for the same consideration, by the giving of the same or similar facilities to all alike in the course of one and the same business carried on by it.
- iii) Lastly the Club was held not to be a trade or professional or similar association u/s 10(6) of the Income-tax Act,1922.

20. **Specific services-** Section 10(6) of 1922 Act and Section 28(iii) of 1961 Act- The mutuality principles were held to be not applicable in the case of Indian Tea Planters Association Vs CIT,WB (1971) 82 ITR 322(Cal) in view of specific services being performed which were taxable u/s 10(6) of the 1922 Act. Similarly in the case of CIT WB Vs Calcutta Stock Exchange Association Ltd (1959) 36 ITR 222(Cal) it was held that entrance fees and subscriptions paid by members for employing authorized assistants and fees paid by members for including new companies in the stock exchange list was specific services and taxable u/s 10(6). This case was followed in the case of Delhi Stock Exchange Association Ltd Vs CIT Delhi (1961) 41 ITR 495(Del).

## 21. **Types of Income**

### Clubs/Association

- i) Entrance fee
- ii) Monthly fees
- iii) Receipt from rent
- iv) Receipt from games and supply of food etc

### Housing Society

- i) Monthly maintenance charges
- ii) Reimbursement of electricity charges
- iii) Reimbursement for common repairs
- iv) Transfer fees
- v) Non occupancy charges
- vi) No objection fees
- vii) Interest on savings deposit
- viii) Interest on fixed deposit

#### **22. Whether to claim mutuality or charity or both?**

A question arises as to if in the case of an organization the provisions of charity and mutuality both are applicable, then which provisions should be applied. It is always advisable to apply mutuality provisions since the income is totally exempt in such cases without any fetters whereas in case of charitable organizations, there are conditions regarding utilization of funds and other statutory obligations.

#### **23. Provisions of Income-tax Act,1961 and how to claim in Income-tax return?**

The provisions of Income-tax Act,1961 do not deal with Mutuality directly and it is only to be inferred that since there is no income in case of mutuality , there is no need for any application of the provisions of income-tax Act,1961. The principles relating to mutuality have evolved in view of the decisions of the various Courts. It is only regarding mutual insurance that specific provision has been made in Section 2(24) to treat the same as income. Also Section 28(iii) deals with specific services performed by association for its members which are brought within the tax net .

#### **24. Partnership -loans to Partners and other business-whether mutuality applicable** In the case of Anupam enterprises Vs ITO (2010) 322 ITR 230(Kar) it was held that if a partnership is created not only for the purpose of advancing loans to partners but for other purposes also and for lending to third parties, in such a situation the mutuality is not applicable. See Also CIT Vs Natraj finance corporation (1989) 169 ITR 732(AP).

#### **25. Chit fund-V Raj Kumar Vs CIT(2014) 363 ITR 21(Mad)**

The hon'ble Madras High court held that where chits are run as a business by a third party and assessee subscribes to that merely as a subscriber, the dividend income received over and above

what has been subscribed by the assessee, has to be assessed as income and cannot be claimed as exempt on principles of mutuality.

26. **Chit fund-** Soda Silicate and Chemical works Vs CIT (1989)  
179 ITR 588 (P&H)

In the said case , the court observed that the dominant motive which prompts most people to join chit fund schemes is to avail themselves of the facility of bidding for the chits when they are in urgent need of finance so that they may receive the chit amount in a lump sum as a loan with the facility of repaying it in monthly installments. A chit fund does, no doubt incidentally partake of the nature of saving scheme also. But unless the amounts are advanced to the prizing subscribers through a scheme of competitive bidding or by drawing lots, there will no income derived either by way of interest or by way of amounts forgone by the bidders at the auction. Thus, the chit fund is primarily intended to operate as a scheme for advancing loans from the common fund to the subscribers, their turns for getting such loans being determined either by auction or by drawing lots.

It was held that the contributions made to chit fund cannot be treated as revenue expenditure nor the receipt of any amount therefrom can be treated as a business receipt.

27. **Interest income of a society-whether mutuality applicable.** Wankaner Jain Social Welfare society Vs CIT(2003)  
260 ITR 241(Mad)

Though a member was of necessity also a depositor he was not required to be a borrower. That was wholly optional. The income of the fund was by way of interest and such interest was received only from those who borrowed from it. The fact that the money that was lent came out of deposits made by the members who had borrowed as also the deposits made by the members who had not chosen to raise any loan would not make any difference so far as the need for establishing identity between the contributor and the participator vis-à-vis interest income. It is enough to show that a person had a right to be the contributor even though he did not contribute.

## Conclusion

There are many more cases where mutuality can be claimed. However, an important point to be noted is that commercial motive must not be there in order to claim mutuality. The present note deals with the direct tax aspect of mutuality, though in indirect tax also the concept of mutuality is there.

# THANK YOU

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