

**INCOME TAX APPELLATE TRIBUNAL
DELHI BENCH "SMC": NEW DELHI**

BEFORE SHRI AMIT SHUKLA, JUDICIAL MEMBER

ITA Nos.: -2008, 2009, 2010/Del/2018
A.Y.s: 2012-13, 2013-14, 2014-15

Swarn Jayanti Rail Nagar Flat Owners Association, A-1, Sector -50 NOIDA – 201307	vs.	ITO, Exemption Ward, Ghaziabad
(Appellant)		(Respondent)

ITA Nos. 3781,3782,3783/Del/2018
A.Y.s: 2012-13, 2013-14, 2014-15

Swarn Jayanti Rail Nagar Flat Owners Association, A-1, Sector -50 NOIDA – 201307	vs.	Commissioner of Income Tax (Appeal) – 1, Noida
(Appellant)		(Respondent)

Stay Nos. 558,559,560,561,562, 563/Del/2018
(In ITA Nos. 2008, 3781, 2009, 3782, 2010, 3783/Del/2018)
A.Ys. 2012-13, 2012-13, 2013-14, 2013-14, 2014-15

Swarn Jayanti Rail Nagar Flat Owners Association, A-1, Sector -50 NOIDA – 201307	vs.	ITO, Exemption Ward, Ghaziabad
(Appellant)		(Respondent)

Assessee by:	Shri G.C. Srivastava, Advocate Shri Suvinay Dash, Advocate
Department by :	Shri C.P. Singh, Sr.DR
Date of Hearing	10/09/2018
Date of pronouncement	28/11/2018

ORDER

The aforesaid appeals have been filed by the assessee against separate impugned order of even date 29.11.2017, passed by Ld. CIT (Appeals) 1 Noida, for the quantum of assessment passed u/s 143(3) for the assessment years 2012-13, 2013-14 and 2014-15; and order dated 23.3.2018 in relation to the penalty proceedings u/s 271(1)(c) for the same assessment years. Since the issues involved in all the appeals are common arising out of identical set of facts, therefore, they were heard together and are being disposed of by way of this consolidated order.

2. First, I will take up the quantum of appeals for the assessment years 2012-13 to 2014-15, wherein the issue involved is addition on account of disallowance of interest and disallowance of entire receipts shown by the assessee and disallowing the expenditure claimed. For the sake of ready reference, the grounds of appeal for the assessment year 2012--13 are reproduced hereunder: -

- “1. *That the AO erred in disregarding the nature of the Appellant society and adding back the amount of Rs. 17,06,920 being bank interest (Rs. 16,92,520) and interest income from cable operator (Rs. 14,400) to the income of the Appellant.*
2. *That the CIT (A) grossly erred in enhancing the income of the appellant from Rs. 17,06,920 to Rs. 36,00,387 by treating the entire receipts, including amounts received from its members, as income of the Appellant, in addition to disallowing the entire expenditure incurred.*

3. *That the claim of exemption of income on the ground of principle of mutuality nr on the ground that the Appellant society was entitled to the benefit of Section 11 have already been examined by the Hon'ble ITAT in Appellant's own case for previous years and that AO and CIT (A) grossly erred in not following the rule consistency.*
4. *That the AO and CIT (A) disregarded various judicial precedents in this regard. on the issue of mutuality.*
5. *The appellant craves leave to alter or add any other ground of appeal."*

3. Facts in brief are that the appellant association, 'Swarn Jayanti Rail Nagar Flat Owners Association' is a society registered u/s Societies Registration Act 1860, which was formed under the scheme of providing housing to serving and retired; and widows of employees of Indian Railways and PSUs established by the Ministry of Railways on no profit and no loss basis through the Indian Railway Welfare Organisation (IRWO). It is engaged in providing common services such as general maintenance and upkeep of the housing society, sanitation, security, general common lighting, working of lifts, water supply, etc. which are in the nature of public services. Members of the society receive no benefit from the Appellant Association *qua* their personal premises. Looking to its activities that the Society was carrying out charitable activities in the nature of 'general public utilities', it was granted registration u/s 12A vide order dated 24.4.2007 by the Ld. Commissioner of Income Tax.

4. For the assessment year 2012-13, as against the 'Nil' return of income filed by the assessee, Ld. AO had made an addition of Rs. 17,06,920/- arising out of bank interest income of Rs. 16,92,520/-

and interest received on income tax refund and from cable operator of Rs. 14,200/-. The amount was claimed exempt by the appellant society under the 'principle of mutuality' and also u/s 11. The main reasoning given by the AO was that the entire income of the assessee is not being utilised for any charitable activity albeit for the benefit of the members of the society and for running of the society, therefore, it cannot be said that society is carrying out any charitable activities for which it was granted exemption u/s 12A. He further held that interest income is to be taxed as 'income from other source', because interest on investment of surplus fund would not satisfy the 'principle of mutuality'. After referring to various decisions, he taxed the entire interest income of the assessee.

5. Now from the stage of first appeal, Ld. CIT(A) not only the action of the AO in taxing the entire interest receipts was upheld but he has also enhanced the income by further disallowing the entire amount /contribution received by the assessee from its members on the ground that, on the one hand assessee holds registration u/s 12A and on the other benefit of exemption under 'principle of mutuality' is claimed. He held that same would not available to it, because mutuality and charitable activity do not go hand in hand. Accordingly, he enhanced the taxable income to Rs. 36,00,387/-. Not only that, he also commented upon granting of registration by the CIT that assessee was not AT ALL eligible for granting of registration u/s 12A as appellant has mislead the authority while getting the registration u/s 12A that it is carrying out charitable activity. Though he made very serious allegation as to how the appellant society has made misrepresentation for obtaining the registration u/s 12A. However, he did not adjudicate the said issue which otherwise also he could not have overridden the order passed by his coordinate authority in

granting registration u/s 12A. Further, he held that assessee is not doing any charity by helping the poor and needy person, but in fact he is helping to itself, i.e., to its members and held that being a charitable society it cannot claim benefit of 'principle of mutuality'. He also defied the earlier Tribunal order passed in favour of the assessee on this score, on the ground that it is not applicable on the issues adjudicated by him the present appeal. He also held that, since appellant society is giving benefit to its members only, therefore, provision of Section 13 are also violated. Accordingly, he taxed the entire receipts as income.

6. Before us, Ld. Counsel for the assessee, Shri G.C. Srivastava submitted that the finding of the Ld. CIT(A) is in utter disregard of the order of the Tribunal for the earlier years, especially for the assessment years 2004-05 and 2010-11, which was consistently being followed by the department in all the years. The Tribunal has upheld the applicability of 'principle of mutuality' despite the fact that appellant enjoyed the benefit of registration u/s 12A. On the issue of doctrine of mutuality, he submitted that the appellant association is created by IRWO for a specific purpose of maintenance of common areas constructed by IRWO and allotted to members. IRWO also collected lump sum maintenance charges from the members at the time of allotment and created a corpus, which was at the disposal of the Appellant Association with a definite mandate that interest income from such corpus would be utilized only for the maintenance of the housing society. The contributors of the fund were the members and the proceeds were utilized only for the common facilities of the contributors to the fund. Thus, the doctrine of mutuality completely applies in this case. Based on these facts only, the Tribunal in the assessment year 2004-05 has accepted the claim of the assessee on identical additions. He also relied upon the judgment of Hon'ble Delhi

High Court in the case of **All India Oriental Bank of Commerce Welfare Society 184 CTR 274 (Del)**. He further argued that here in this case the conditions for applicability of the principle of mutuality will also extend to the income earned by the society in the form of interest on the funds received from its members which has been deposited in the bank in the form of FDRs and the interest accrued thereon has been applied for the maintenance and welfare of the members only. In support, he relied upon the judgment of Hon'ble Jurisdictional High Court in the case of **CIT vs. Delhi Gymkhana Club Limited (2011) 339 ITR 525**; and **CIT vs. Talangang Cooperative Group Housing Society Ltd. (2010) 195 Taxman 110 (Delhi)**. He pointed out that all these decisions have been referred and relied upon by the Tribunal in the earlier years. On the issue of benefit of exemption u/s 11, he submitted that, whence assessee was granted registration u/s 12A, then it is incumbent upon the AO to compute the income in accordance with Section 11. Even if principle of mutuality is not held to be applicable, then also assessee is entitled for exemption /benefit u/s 11 and two alternative claims can always be advanced. Once registration u/s 12A is continuing then it is not open for the AO or Ld. CIT(A) to show that assessee association is not a charitable institution. The charitable activity need not be for the benefit of whole mankind but it would be sufficient if the intention is to benefit a section of the public as distinguished from individuals. In so far as applicability of section 13 as invoked by the Ld. CIT(A), he submitted that, first of all, no amount has been spent for the benefit of any individual members of the association, because the mandate of the association was that amount will be spent only for the maintenance and upkeep of common area facilities of the building and of common services. None of the provisions contained in clause (a) to (h) of section 13(2) is applicable or could have been invoked to deny

the benefit of exemption. Thus, under no circumstance's income could have been taxed by the authorities below. Even otherwise also, the net income as per income and expenditure account was much below the statutory deduction/allowance of 15% as applicable in section 11 which is evident from the following net income: -

- (i) A.Y. 2012 – 13 - Rs. 544,992/-
- (ii) A.Y. 2013 – 14 – Rs. 453,296/-
- (iii) A.Y. 2014 - 15 – Rs. 222,554/-

7. On the other hand, Ld. DR strongly relied upon the judgement of Hon'ble Supreme Court in the case of **Bangalore Club vs. CIT 350 ITR 509 (SC)** on the point that interest earned by the assessee society is from the bank and therefore, it could not be eligible for exemption under principle of mutuality. On the issue of taxability of interest and other disallowance made by the Ld. CIT(A), he strongly relied upon the order of the Ld. CIT(A).

8. By way of rejoinder, Shri G.C. Srivastava submitted that the judgment of Hon'ble Supreme Court in the case of **Bangalore Club** was peculiar to its facts, because there the interest was earned on the fixed deposits from its member banks which were doing commercial transaction and hence it was on this background it was held that principle of mutuality will not apply on such interest income. In that case the club from time to time was deposited surplus income in fixed deposits of member banks as an investment to earn higher returns which does not hold true in the case of appellant association. Here the flats were constructed by the IRWO from the contributions made by the members on no profit no loss basis. After the construction of the said flats the housing society was entrusted to an association of flat owners created at the behest of IRWO to look after the welfare of

residents by providing necessary services and facilities to enable funds being made available to such societies. IRWO had created an onetime maintenance fund from the contribution of the respective flat owners prior to handing over of flats so that the interest income from such fund is contributed towards the welfare and maintenance of the housing society. This onetime maintenance fund was kept in a joint account with the nationalised bank as a fixed deposit in joint names of IRWO and the appellant. The interest accruing from such fund was used entirely towards maintenance of the housing society. In the case of Bangalore Club, members had breached the privity attached to their membership of the club by earning profits for themselves from the amounts placed with them as FDs, which goes against the principle of mutuality. Thus, the judgment of Hon'ble Apex Court would not be applicable on the facts of the assessee's case and neither the ratio of principle laid down therein.

9. I have heard the rival submissions and also perused the relevant finding given in the impugned order. First of all, it is an undisputed fact that assessee was granted registration u/s 12A by the CIT and such a registration has neither been revoked nor cancelled by any competent authority. Hence it is a *fait accompli*. Once the assessee has been granted registration u/s 12A, then it is an incumbent upon the AO to mandatorily compute the income u/s 11 to 13. Such a benefit can only be denied if the conditions laid down u/s 11 to 13 are not fulfilled. AO or Ld. CIT(A) cannot sit upon or review the registration order granted by the authority granting registration u/s 12A and hold that assessee is not carrying out any charitable activities or it has misled the CIT, while applying for registration u/s 12A. If there is any misrepresentation of facts, then that particular authority alone has the power to revoke his order or cancel the

registration. Thus, comments upon by the Ld. CIT(A) in the impugned order was not only unwarranted but also it does not hold ground.

10. Here the AO has disallowed the interest income, *firstly*, by holding that it violates the 'principle of mutuality'; and *secondly*, interest income is to be taxed under the head 'income from other sources'. Here one cannot deny the fact that the flats constructed by IRWO for its employees were from the contribution made by the members on no profit and no loss basis. It is after the construction of said flats, the appellant society was formed which was entrusted to look after the welfare of the residents by providing necessary services and facilities. Onetime maintenance fund was collected by way of contribution of the members prior to handing over of flats to them so that the interest earned from such fund is contributed towards the welfare and maintenance and such fund was kept in fixed deposits in the joint name of IRWO and appellant society in a Nationalised Bank and the interest accrued thereon has been solely used for the maintenance of the housing society, i.e., for the members. Income by way of interest is nothing else but income derived from property held under the trust as stipulated in section 11, because the maintenance fund is from the member of appellant association on which it has derived income and therefore, the benefit of section 11 cannot be denied. If appellant society is recognised and registered as a charitable organisation u/s 12A, then ostensibly income and the benefit thereon have to be computed strictly in accordance with section 11. Accordingly, we hold that entire interest income is eligible for computation and benefit of section 11.

11. In so far as the allegation of Ld. CIT(A) that there is a violation of section 13, because the entire fund and the interest has been utilised for its members and therefore, benefit of section 11 gets

forfeited. I am unable to appreciate such line of reasoning, because, if the appellant society has been formed by way of association of members for maintenance of the housing society for the benefits of all the members, then it cannot be held that all the members of the association are the 'persons' as defined in Sub section (3) of Section 13. Nowhere it has been spelt by the Ld. CIT(A) as to which of the conditions laid down in section 13 (1) has been violated. Nowhere there is any finding that the amount has been spent for benefit of any particular individual member. The entire mandate of appellant association was that the amount received by way of interest would be spent only for the maintenance and upkeep of common area facilities of the building and of common services for the benefit of all the members and not to any individual member. Thus, such an allegation of the Ld. CIT(A) deserves to be rejected. Accordingly, we hold that entire receipts by the Ld. CIT(A) is unsustainable in law and on facts.

12. Even when the Ld. CIT(A) has held that assessee is neither eligible for benefit u/s 11 nor its receipts fall within the doctrine of mutuality, then its income should have been computed under the normal provision of Act and only the net income could have been brought to tax. Here in this case the net income for the assessment year is Rs. 5,44,992/- and in the other years, as stated above, is much below that. Hence, the action of the Ld. CIT(A) in taxing the entire income is not justified under any provisions of law. Accordingly, we hold that the entire interest income earned by the assessee is eligible for benefit of section 11; and since the net income as per expenditure account is much below the prescribed limit of 15%, therefore, no income is held to be taxable and consequently in all the years income has to be assessed at 'nil' and consequently the entire addition made by the AO and CIT(A) is directed to be deleted.

13. Though we have already deleted the entire addition and the issue of applicability of 'principle of mutuality' has become purely academic, however, since this issue has been argued vehemently by both the parties and is permeating in all the years, therefore I think fit that the issue of principle of mutuality in respect of interest income from the bank and other small incidental receipts needs to be adjudicated.

14. Already the background and the facts of the case that the appellant association was created by IRWO for the specific purpose of maintenance of common areas of the flats constructed by the IRWO and allotted to its members. IRWO had collected lumpsum maintenance charges from the members who are basically serving and retired and widows of employees of the Indian railways and Public Sector Undertakings established by Ministry of Railways. Such lumpsum maintenance charges collected from the members at the time of allotment is the corpus which has been put at the disposal of the appellant association with the mandate that the interest income earned from corpus would only be utilised only for the maintenance of the housing society, i.e., the purpose for which it was found. Nothing has been brought on record or any material has been found that the interest income received has not been utilised for the benefit of the members, i.e., for the maintenance and upkeep of the residential and common area and facility. It is also not the fact that the banks in which FDR was kept was also a member of the appellant association. The question of commerciality arises only where entities claiming to be mutual concern have an object to carry on a particular business and generate income from members and non-members through their business. Here appellant does not run any activity or profit earning with a profit motive or from which it can derive any profit. Much emphasis has been laid by the Ld. DR upon the judgment of Hon'ble

Apex Court in the case of **Bangalore Club vs. CIT** (supra), wherein Hon'ble Supreme Court on the facts of that case found the club from time to time was depositing surplus income in the form of fixed deposits of member banks, as an investment to earn higher return. The club has claimed interest earned on fixed deposits kept with certain banks which were corporate members of the assessee and claim exemption on the basis of doctrine of mutuality on the interest earned on fixed deposits kept with non-member banks which were offered to tax. On these facts, the Hon'ble Supreme Court had held that the condition of claim of mutuality is not satisfied. In sum and substance, the observations and the findings of the Hon'ble Apex Court can be summarised as under: -

- *Coming to the facts of the case, the assessee is an AOP. The concerned banks are all corporate members of the club. The interest earned from fixed deposits kept with non-member banks was offered for taxation and the tax due was paid. Therefore, it is necessary to examine the case of the assessee, in relation to the interest earned on fixed deposits with the member banks, on the touchstone of the three cumulative conditions, enumerated above.*
- *Firstly, the arrangement lacks a complete identity between the contributors and participators. Till the stage of generation of surplus fund, the setup resembled that of a mutuality; the flow of money, to and fro, was maintained within the closed circuit formed by the banks and the club, and to that extent, nobody who was not privy to this mutuality, benefited from the arrangement. However, as soon as these funds were placed in fixed deposits with banks, the closed flow of funds between the banks and the club suffered from deflections due to exposure to commercial banking operations. During the course of their*

banking business, the member banks used such deposits to advance loans to their clients.

- *Hence, in the instant case, with the funds of the mutuality, member banks engaged in commercial operations with third parties outside of the mutuality, rupturing the 'privity of mutuality', and, consequently, violating the one to one identity between the contributors and participators as mandated by the first condition. Thus, in the instant case, the first condition for a claim of mutuality is not satisfied.*
- *As aforesaid, the second condition demands that to claim an exemption from tax on the principle of mutuality, treatment of the excess funds must be in furtherance of the object of the club, which is not the case here. In the instant case, the surplus funds were not used for any specific service, infrastructure, maintenance or for any other direct benefit for the member of the club. These were taken out of mutuality when the member banks placed the same at the disposal of third parties, thus, initiating an independent contract between the bank and the clients of bank, a third party, not privy to the mutuality.*
- *This contract lacked the degree of proximity between the club and its member, which may in a distant and indirect way benefit the club, nonetheless, it cannot be categorized as an activity of the club in pursuit of its objectives. It needs little emphasis that the second condition postulates a direct step with direct benefits to the functioning of the club. For the sake of argument, one may draw remote connections with the most brazen commercial activities to a club's functioning. However, such is not the design of the second condition. Therefore, it stands violated.*

- *The facts at hand also fail to satisfy the third condition of the mutuality principle i.e. the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves. This principle requires that the funds must be returned to the contributors as well as expended solely on the contributors.*
- *True, that in the instant case, the funds do return to the club. However, before that, they are expended on non-members i.e. the clients of the bank. Banks generate revenue by paying a lower rate of interest to club-assessee, that makes deposits with them, and then loan out the deposited amounts at a higher rate of interest to third parties. This loaning out of funds of the club by banks to outsiders for commercial reasons, snapped the link of mutuality and thus breaches the third condition.*
- *There is nothing on record which shows that the banks made separate and special provisions for the funds that came from the club, or that they did not loan them out. Therefore, clearly, the club did not give, or get, the treatment a club gets from its members; the interaction between them clearly reflected one between a bank and its client. This directly contravenes the third condition.*
- *In the present case, the interest accrues on the surplus deposited by the club like in the case of any other deposit made by an account holder with the bank.*
- *It may be added that the assessee is already availing the benefit of the doctrine of mutuality in respect of the surplus amount received as contributions or price for some of the facilities availed by its members, before it is deposited with the bank. This surplus amount was not treated as income; since it was the residue of the*

collections left behind with the club. A facade of a club cannot be constructed over commercial transactions to avoid liability to tax. Such setups cannot be permitted to claim double benefit of mutuality.

- *Unlike the aforesaid surplus amount itself, which is exempt from tax under the doctrine of mutuality, the amount of interest earned by the assessee from the member banks will not fall within the ambit of the mutuality principle and would therefore, be exigible to tax in the hands of the assessee-club.”*

15. In the aforesaid case it was clearly found that the arrangement between the club and its corporate members had complete identity and the member banks were having commercial dealings from the funds collected by the club from its members for its own benefit. The doctrine of mutuality rest upon the fundamental principle that the person cannot make profit from himself and any amount received amongst the members cannot be regarded as income and such a receipt does fall within the charging sections of the Income Tax Act and hence same cannot be taxed. There has to be complete identity between the participators and contributors which form mutual association and action of participators and contributors must be in furtherance of mandate of association, i.e., activity which gives the benefit to its members. Here in this case, the appellant association has been found purely for the benefit of members and interest income earned from onetime contribution has been utilised purely and exclusively for the benefit of the members, i.e., maintenance and upkeep of the residential flats and maintenance of the area and common services. The bank in which money was deposited in the form of FDR was neither a member of the appellant association nor was I any way participating in the activity of the association nor being

benefited by any of the activities. Thus, the facts of the present case are clearly different and hence the ratio and the principle laid down by the Hon'ble Apex Court as discussed above is not applicable at all. Here all the ingredients of applicability of mutuality exists; and accordingly, no such income can be taxed in view of the principle of mutuality. Thus, on this score also, we hold that no income is chargeable to tax in the case of assessee.

16. In the result appeal of the assessee is allowed.

17. In so far as the appeals relating to penalty proceedings u/s 271(1)(c) is concerned, in view of our finding given above that no income is taxable in the hands of the appellant association, then levy of penalty u/s 271(1)(c) has no legs to stand and accordingly, penalty levied in all the years impugned before us stands deleted.

18. In the result appeals of the assessee are allowed.

19. Since the appeals preferred by the assessee have been disposed off, the present stay applications have become infructuous and are dismissed as such.

Order pronounced in the open court on 28th November, 2018.

Sd/-

(AMIT SHUKLA)

JUDICIAL MEMBER

Dated: 28 /11 /2018

Veena

Copy forwarded to

1. Applicant
2. Respondent

3. CIT
4. CIT (A)
5. DR:ITAT

ASSISTANT REGISTRAR
ITAT, New Delhi