IN THE INCOME TAX APPELLATE TRIBUNAL, 'SMC' BENCH MUMBAI

BEFORE: SHRI M.BALAGANESH, ACCOUNTANT MEMBER
&
SHRI AMARJIT SINGH, JUDICIAL MEMBER

ITA No.446/Mum/2020
(**Assessment Year :2010-11**)
&
ITA No.447/Mum/2020
(**Assessment Year :2011-12**)

M/s. United Services Club Robert Road, Near R C Church Colaba, Mumbai – 400 005	Vs.	ITO 17(3)(5) Room No.137, 1st Floor Aayakar Bhavan M.K.Road, Mumbai – 400 020
PAN/GIR No.AAABU0047P		
(Appellant)	..	**(Respondent)**

Assessee by	None
Revenue by	Shri Abdul Hakeem
Date of Hearing	**22/11/2021**
Date of Pronouncement	**25/11 /2021**

आदेश / O R D E R

***PER M. BALAGANESH (A.M)*:**

These appeals in ITA No.446/Mum/2020 & ITA No.447/Mum/2020 for A.Y.2010-11 & 2011-12 arises out of the order by the ld. Commissioner of Income Tax (Appeals)-28, Mumbai in appeal No.CIT(A)-28/ITBA-10272/ITO-17(3)(5)/2017-18 & CIT(A)-28/ITBA-10253/ITO-17(3)(5)/2018-19 dated 24/10/2019 (ld. CIT(A) in short) against the order of assessment passed u/s.143(3) r.w.s. 147 of the Income Tax Act, 1961 (hereinafter referred to as Act) dated 28/12/2012 by the ld. Income Tax Officer- 17(3)(5) (hereinafter referred to as ld. AO).

As identical issues are involved in both these appeals, they are taken up together and disposed of by this common order for the sake of convenience.

2. The only identical issue to be decided in these appeals is as to whether the ld. CIT(A) was justified in confirming the addition made by the ld. AO on account of interest income earned from bank deposits as the same would not be governed by the principle of mutuality.

3. None appeared on behalf of the assessee. A notice of hearing scheduled on 28/06/2021 was served on the assessee and assessee had taken adjournment on the said date vide its letter dated 28/06/2021. Thereafter, the notice of hearing scheduled on 05/10/2021 was also served on the assessee. Since sufficient opportunities were given to the assessee, and the issue involved herein is already covered by the decision of the Hon'ble Supreme Court, the Bench felt it appropriate to dispose of the appeals after hearing the ld. DR and based on materials available on record.

3.1. We find that assessee is a club which was established in 1928 set up with the primary object to provide welfare activities for the members who are very senior and highest ranked officers of armed forces in the form of sports and recreational facilities. All the members of this club are high rank officers of defence / military forces. No other member other than the defence are allowed to be member of this club. All the facilities are completely and solely used by the members of this club and persons other than the members are not allowed to even enter the club. The person can be a member of this club by only having membership provided by the Government of India to the defence person. The club has more than 12,000 members. The receipts are generated by the club only from its members. In addition to its income from providing food to recreational and residential facilities to its members, it had also earned interest income from fixed

deposits kept with bank (non-member). The assessee claimed the said interest income as exempt on the basis of principle of mutuality. The ld. AO held that since bank, not being a member of the club, even though the funds had been generated from members which had eventually been utilised for making investment in bank deposits by the assessee club, the accretion to the said deposit in the form of interest income would not be eligible for exemption on the basis of principle of mutuality as the said interest income is earned by the club from non-member which is bank. The ld. AO placed reliance on the decision of the Hon'ble Supreme Court in the case of Bangalore Club vs. CIT reported in 29 taxmann.com 29 in support of his contentions in this regard. The ld. CIT(A) upheld the action of the ld. AO.

3.2. We find that the issue in dispute has been purely settled against the assessee by the decision of the Hon'ble Supreme Court in the case of Bangalore Club referred to supra wherein the Hon'ble Supreme Court examined the taxability of interest earned on fixed deposits on the touchstone of three cumulative conditions and held as under:-

> ***"26.*** *Firstly, the arrangement lacks a complete identity between the contributors and participators. Till the stage of generation of surplus funds, 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 present 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 case before us the first condition for a claim of mutuality is not satisfied.*
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> ***27.*** *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 the 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.

28. *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 present 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, in our opinion, snaps the link of mutuality and thus, breaches the third condition.*

29. *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 as elucidated in Styles (Surveyor of Taxes) and Kumbakonam Mutual Benefit Fund Ltd. cases (supra). Rowlatt J., in our opinion, correctly points out that if profits are distributed to shareholders as shareholders, the principle of mutuality is not satisfied. In Thomas (supra), at pp. 822-823, he observed thus :*

> *"But a company can make a profit out of its members as customers, although its range of customers is limited to its shareholders. If a railway company makes a profit by carrying its shareholders, or if a trading company, by trading with the shareholders - even if it limited to trading with them - makes a profit, that profit belongs to the shareholders, in a sense, but it belongs to them qua shareholders. It does not come back to them as purchasers or customers. It comes back to them as shareholders, upon their shares. Where all that a company does is to collect money from a certain number of people - it does not matter whether they are called members of the company, or participating policy holders - and apply it for the benefit of those same people, not as shareholders in the company, but as the people who subscribed it, then, as I understand the New York case, there is no profit. If the people were to do the thing for themselves, there would be no profit, and the fact that they incorporate a legal entity to do it for them makes no difference, there is still no profit. This is not because the entity of the company is to be disregarded, it is*

> *because there is no profit, the money being simply collected from those people and handed back to them, not in the character of shareholders, but in the character of those who have paid it. That, as I understand it, is the effect of the decision in the New York case."*
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> *(Emphasis supplied)*

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.

30. *An almost similar issue arose in Kumbakonam Mutual Benefit Fund Ltd. case (supra). The facts in that case were that the assessee, namely, Kumbakonam Mutual Benefit Fund Ltd., was an incorporated company limited by shares. Since 1938, the nominal capital of the assessee was Rs.33,00,000/- divided into shares of Rs.1/- each. It carried on banking business restricted to its shareholders, i.e., the shareholders were entitled to participate in its various recurring deposit schemes or obtain loans on security. Recurring deposits were obtained from members for fixed amounts to be contributed monthly by them for a fixed number of months as stipulated at the end of which a fixed amount was returned to them according to published tables. The amount so returned, covered the compound interest of the period. These recurring deposits constituted the main source of funds of the assessee for advancing loans. Such loans were restricted only to members who had, however, to offer substantial security therefor, by way of either the paid up value of their recurring deposits, if any, or immovable properties within a particular district. Out of the interest realised by the assessee on the loans which constituted its main income, interest on the recurring deposits aforesaid was paid as also all the other outgoings and expenses of management and the balance amount was divided among the members pro rata according to their share-holdings after making provision for reserves, etc., as required by the Memorandum or Articles aforesaid. It was not necessary for the shareholders, who were entitled to participate in the profits to either take loans or make recurring deposits.*

31. *On these facts, as already noted, the Court distinguished Styles (Surveyor of Taxes) case (supra) and opined that the position of the assessee was no different from an ordinary bank except that it lent money and received deposits from its shareholders. This did not by itself make its income any less income from business. In our opinion, the ratio of the said decision is on all fours to the facts at hand. The interest earned by the assessee even from the member banks on the surplus funds deposited with them had the taint of commerciality, fatal to the principle of mutuality.*

32. *We may add 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 façade 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. We feel that the present case is a clear instance of what this Court had cautioned against in Bankipur Club (supra), when it said:*

> *"... if the object of the assessee company claiming to be a "mutual concern" or "club", is to carry on a particular business and money is realised both from the members and from non-members, for the same consideration by giving the same or similar facilities to all alike in respect of the one and the same business carried on by it, the dealings as a whole disclose the same profit earning motive and are alike tainted with commerciality. In other words, the activity carried on by the assessee in such cases, claiming to be a "mutual concern" or Members' club" is a trade or an adventure in the nature of trade and the transactions entered into with the members or non-members alike is a trade/business/transaction and the resultant surplus is certainly profit - income liable to tax. We should also state, that "at what point, does the relationship of mutuality end and that of trading begin" is a difficult and vexed question. A host of factors may have to be considered to arrive at a conclusion. "Whether or not the persons dealing with each other, is a "mutual club" or carrying on a trading activity or an adventure in the nature of trade" is largely a question of fact [Wilcock's case - 9 Tax Cases 111, (132) C.A. (1925) (1) KB 30 at 44 and 45]."*
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> *(Emphasis supplied)*

> ***33.*** *In our opinion, 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 afore-noted four banks will not fall within the ambit of the mutuality principle and will therefore, be exigible to Income-Tax in the hands of the assessee-club.*

3.3. Respectfully following the same, the grounds raised by the assessee are dismissed for both the years.

4. In the result, both the appeals of the assessee are dismissed.

Order pronounced on 25/11/2021 by way of proper mentioning in the notice board.

Sd/-	**Sd/-**
(AMARJIT SINGH)	**(M.BALAGANESH)**
JUDICIAL MEMBER	**ACCOUNTANT MEMBER**

Mumbai; Dated 25/ 11/2021

KARUNA, *sr.ps*

Copy of the Order forwarded to :

1. The Appellant
2. The Respondent.
3. The CIT(A), Mumbai.
4. CIT
5. DR, ITAT, Mumbai
6. Guard file.

//True Copy//

BY ORDER,

(Asstt. Registrar)
ITAT, Mumbai