

आयकर अपीलीय अधिकरण, हैदराबाद पीठ में  
IN THE INCOME TAX APPELLATE TRIBUNAL  
HYDERABAD BENCHES "B", HYDERABAD

BEFORE  
SHRI K.NARASIMHA CHARY, JUDICIAL MEMBER  
&  
SHRI MADHUSUDAN SAWDIA, ACCOUNTANT MEMBER

आ.अपी.सं / ITA Nos. 662 to 664/Hyd/2023  
(निर्धारण वर्ष / Assessment Years: 2016-17, 2017-18 & 2018-19)

Andhra Pradesh Advocates Vs. Income Tax Officer,  
Welfare Fund, Ward-8(2),  
Hyderabad Hyderabad  
[PAN : AAALA1487F]

अपीलार्थी / Appellant

प्रत्यर्थी / Respondent

निर्धारिती द्वारा/Assessee by:

Shri P.R. Suresh, C.A

राजस्व द्वारा/Revenue by:

Shri Kumar Pranav, CIT(DR) &  
Shri Rahul Singhania, Sr.DR

सुनवाई की तारीख/Date of hearing:

18/07/2024

घोषणा की तारीख/Pronouncement on:

24/07/2024

आदेश / ORDER

**PER K. NARASIMHA CHARY, J.M:**

Aggrieved by the separate but identical orders, all dated 31/10/2023 passed by the learned Commissioner of Income Tax (Appeals)- National Faceless Appeal Centre (NFAC), Delhi ("Ld. CIT(A)"), in the case of Andhra Pradesh Advocates Welfare Fund ("the assessee") for the assessment years 2016-17, 2017-18 & 2018-19, assessee preferred these appeals. Since common issues are involved in all these matter, for the sake of convenience, we deem it just and convenient to dispose of these three appeals by way of this common order referring to the facts involved in the year 2016-17.

2. AP Advocates Welfare Fund, the assessee, filed its return of income declaring an income of Rs. Nil in the on 30/03/2018 claiming Exemption under Mutuality, resting its claim on the decision of the Hon'ble Apex Court in the case of CIT vs. Bankipur Club Ltd.; (226 ITR 97 (SC)). Learned Assessing Officer also recorded that the assessee claimed the Status of Local Authority. The case was selected for scrutiny through "CASS" to examine the "deduction against income from other sources". Learned Assessing Officer noticed that the assessee received a sum of Rs. 6,63,48,049/- Life membership fee, Nomination fee, Certificate Fee, Interest on savings bank, Interest on fixed deposit, proceeds from sale of welfare fund stamps, and Miscellaneous receipts and against such receipts claimed deduction at Rs.6,17,81,213/- as expenditure under the head(s) of death benefits, retirement benefits, funeral expenses & financial assistance to advocates and towards Personal & General expenses.

3. Learned Assessing Officer called upon the assessee to explain how the status of the assessee is Local Authority and how the expenditure claimed as deduction is allowable under Act. It was further asked to explain the nexus between the income and the expenditure reported in its return of income. By way of written submissions before the learned Assessing Officer, the assessee contended that the Hon'ble Supreme Court, in CIT vs. Bankipur Club Ltd., established that amounts received by mutual benefit funds, if not tainted by commerciality, are exempt from tax based on the principle of mutuality. It was held that when individuals combine resources for mutual purposes without engaging with external entities, any surplus returned to them is not considered profit. Complete identity between contributors and participators is required, and if this condition is met, the form of association is immaterial. Any surplus is seen as the contributors' own money, exempt from tax. This principle applies even if contributors incorporate themselves into a separate entity.

4. Assessee contended that for mutual societies or concerns, including advocates' clubs, there must be complete identity between contributors

and participants. The label or form of the mutual association is irrelevant. Leading decisions and legal texts, such as "The Law and Practice of Income Tax" by Kanga and Palkhivala, have emphasized that contributors to a common fund and participators in the surplus must be identical. It is not necessary for each advocate to contribute or participate equally; it suffices if contributors have control over the surplus, which can be disposed of or transferred to a similar association upon winding up. This ensures the application of the mutuality principle, exempting such funds from tax.

5. Assessee further contended that Welfare Fund is contributed entirely by advocate subscriptions, fulfills the mutuality principle. According to Hon'ble Supreme Court ruling in the Bankipur Club case, Welfare Fund's profits are exempt from income tax. The Welfare Fund Act's section 23 of The Advocates' Welfare Fund Act, 2001 ("the Central Act") exempts these funds from tax, and even if this section is inapplicable, section 3 of the Central Act and The Andhra Pradesh Advocates' Welfare Fund Act, 1987 ("the State Act"), ensures that all receipts, including interest and dividends, are used solely for advocate benefits. Therefore, Welfare Fund's entire amount is exempt from income tax as contributors and beneficiaries are identical.

6. Assessee explained that advocates presenting vakalatnama in court must affix the appropriate court fee and Welfare Fund stamps, acquired from the local Bar association, representing advocates' contributions to Welfare Fund. This system ensures mutuality, as the same advocates contributing through fees also acquire the stamps. The funds collected are deposited in banks, with interest used for advocate welfare. The mutuality principle applies to these transactions, exempting the surplus from income tax as it constitutes advocates' contributions.

7. It was the further contention of the assessee before the learned Assessing Officer that the welfare fund, formed under the State Act, is an "Artificial Judicial Person" for income tax purposes. The State Act defines

advocates as those admitted to its benefits, with funds credited from various sources, including advocate contributions and government grants. Benefits include payments on cessation or suspension of practice, with eligibility criteria outlined in The State Act. The fund's sources and benefits confirm its mutual nature, satisfying the conditions for tax exemption. Thus, Welfare Fund operates on mutuality principles, ensuring all contributions and benefits are confined within its advocate base. We refer to the contentions of the assessee in a detailed manner here, because the same contentions are consistently raised before the learned CIT(A) and also before us, and it need not be repeated.

8. On a consideration of all the contentions raised by the assessee, Learned Assessing Officer found that the principle of mutuality is not applicable to the interest earned from Savings Accounts and Fixed Deposits, as the contributors (Banks) are not the same as the participants (advocates). Citing Hon'ble Supreme Court's decision in Bangalore Club Vs CIT, it was concluded that the interest earned is tainted by commerciality and not exempt under mutuality. The Assessee's receipt of Life Membership Fees, Nomination Fees, and Certificate Fees from its advocates was, however, accepted as covered by the principle of mutuality.

9. It was further observed by learned Assessing Officer that the majority of contributions to the Fund come from Stamp sales. Advocates must affix Welfare fund Stamps along with court fee Stamps on Vakalats. The requirement of affixing Welfare Stamps creates a lack of identity between contributors and beneficiaries, as not all contributors benefit from the fund. Additionally, clients of the advocates are the actual contributors, reimbursing the cost of the Stamps through legal fees, which means the contributions are not voluntary but rather a commercial transaction. Consequently, the income from Welfare fund Stamps does not qualify for mutuality exemption due to the commercial nature of the transaction and the lack of voluntary contribution.

10. Learned Assessing Officer found that the income claimed under the State Act, is not exempt from tax as The State Act does not apply to the states listed in Schedule II, including the State Act. Additionally, learned Assessing Officer determined that the expenditures claimed by the Assessee, such as Death Benefits, Financial Assistance, Funeral Expenses, Suspension of Practice, and Retirement Benefits, are not allowable under Section 37 of IT Act as they do not have a direct nexus with earning the income and are considered applications of income rather than expenses incurred for business purposes. Only Personal Costs and General Expenses were allowed as they relate directly to the income. He accordingly brought to tax the surplus amount.

11. Aggrieved assessee preferred appeal before the learned CIT(A) and raised all the contentions that were raised before the learned Assessing Officer. On a consideration of all the material before him, in the light of the Assessment order and the contentions raised by the assessee, learned CIT(A), however, observed that the Learned Assessing Officer's decision to deny the exemption on the principles of mutuality was correct. In Bangalore Club vs. CIT (350 ITR 509), Hon'ble Supreme Court established that there must be a complete identity between contributors and participants, and the transactions should not be tainted by commerciality. The Learned Assessing Officer noted that some contributors are not beneficiaries, and clients, rather than advocates, often pay the fees. Thus, the principle of mutuality, which requires voluntary contributions, is not met. Learned CIT(A) upheld the Learned Assessing Officer's decision, agreeing that the transaction lacked the necessary voluntary character.

12. Learned CIT(A) found that the Learned Assessing Officer's logical argument against the exemption for welfare stamp sales was valid. The Learned Assessing Officer highlighted that the stamp sales were compulsory and paid for by clients, indicating a commercial intent. Consequently, this ground of appeal was also decided against the

Assessee, reinforcing the lack of mutuality and voluntary nature in the transactions.

13. Learned CIT(A) considered the Assessee's claim that all receipts and expenditures as per the Welfare Fund Act should benefit the advocates and thus qualify for mutuality-based exemption. This argument was dismissed, as mutuality was not established, and the transactions bore commercial and business intentions, disqualifying them from exemption under the principles of mutuality.

14. Learned CIT(A) upheld the Learned Assessing Officer's view on the exemption under section 23 of the Central Act. The Learned Assessing Officer pointed out that the State Act is listed in Schedule II of the Central Act, making it ineligible for the exemption. Therefore, the claim that all receipts are capital in nature and not taxable was dismissed.

15. Learned CIT(A) addressed the final allegation regarding the deductibility of payments from different income sources. The Learned Assessing Officer had analysed the expenses, such as death benefits, financial assistance, funeral expenses, suspension of practice, and retirement benefits, and found them to be applications of income, not incurred exclusively for earning income. Thus, they were not allowable under section 37 of IT Act. Learned CIT(A) agreed with the Learned Assessing Officer, dismissing these grounds of appeal against the Assessee.

16. Aggrieved by such an order of the learned CIT(A), assessee preferred these appeals. Learned AR, for the first time, in these appeals before the Tribunal took a plea that the examination of the question of mutuality by the learned Assessing Officer is bad under law when the case was selected for limited scrutiny to verify the deductions against income. He argued that on that ground itself, the assessments have to be quashed. Learned AR further argued that the provisions of Central legislation will prevail over the State legislation, when both the enactments operate in the same field. He

further argued that for mutual societies or concerns, including advocates' clubs, complete identity between contributors and participators is essential. The form of the mutual association is irrelevant. According to him, equal contribution or participation is not necessary; it suffices if contributors control the surplus, which can be disposed of or transferred to a similar association upon winding up, ensuring the application of the mutuality principle and exempting such funds from tax.

17. Learned AR emphasized that Advocates' Welfare Fund, funded entirely by advocates' subscriptions, adheres to the mutuality principle. According to Hon'ble Supreme Court ruling in the Bankipur Club case, Advocates' Welfare Fund's profits are exempt from income tax. Section 23 of the Central Act exempts these funds from tax, and even if this section is inapplicable, section 3 of both the Central and Central ensures that all receipts, including interest and dividends, are used solely for advocates' benefits, thus exempting Advocates' Welfare Fund's entire amount from income tax due to the identity between contributors and beneficiaries.

18. Learned AR further explained that advocates presenting Vakalats in court must affix the appropriate court fee and Advocates' Welfare Fund stamps, representing their contributions to Advocates' Welfare Fund . This system ensures mutuality, as the same advocates contributing through fees also acquire the stamps. The collected funds are deposited in banks, with interest used for advocates' welfare. These transactions adhere to the mutuality principle, exempting the surplus from income tax as it constitutes advocates' contributions.

19. Learned AR further contended that Advocates' Welfare Fund, formed under the Advocates' Welfare Fund Act, 1987, is an "Artificial Judicial Person" for income tax purposes. The State Act defines advocates as those admitted to its benefits, with funds credited from various sources, including advocates' contributions and government grants. Benefits include payments on cessation or suspension of practice, with eligibility

criteria outlined in The State Act. The fund's sources and benefits confirm its mutual nature, satisfying the conditions for tax exemption.

20. Learned AR argued that the State Advocates' Welfare Fund, constituted under section 3 of the State Act, 1987, is considered an "Artificial Judicial Person" despite its status as a Local Authority as per PAN. Authorities confirmed this status, but they misunderstood the legislative intent. The formation of Advocates' Welfare Fund is for the benefit of its advocates, mandating that advocates affix a Advocates' Welfare Fund Stamp on the Vakalat, a requirement enforced by judicial officers. Authorities' claim that the sale of Advocates' Welfare Fund Stamps is commercial is nothing but a misunderstanding of the legislative purpose, which is to ensure proportional contributions from advocates.

21. According to the Learned AR the authorities' failure to grasp the contribution method specified by law led to incorrect taxation of the entire receipts without accounting for incurred expenses. Learned AR contended that clients appoint advocates only when representation is required, making the affixing of Advocates' Welfare Fund Stamps a simple legal requirement, not a commercial activity. The legislation aims to benefit advocates, and contributions, including interest earned and Stamp receipts, are intended for this purpose. Authorities' assertion of no nexus between advocates' payments and receipts is disputed by the Learned AR, highlighting that contributions are exclusively from advocates and benefit them solely.

22. Learned AR further argued that authorities' desire to tax the fund disregarded the legal necessity of Stamp affixation as part of court proceedings. The law mandates the Stamp value, and authorities, as a quasi-judicial officer, are bound to adhere to state legislation. The Advocates' Welfare Fund Act ensures that benefits and administrative expenses are covered by the fund, contrary to authorities' isolation of Stamp sales and bank interest for tax purposes. Learned AR argued that

authorities, having accepted that membership fees are exempt based on mutuality, should apply the same principle to gross receipts, and any losses should be offset against Stamp sales and bank interest under the Income Tax Act.

23. Finally, learned AR asserted that contributions are proportionate to the number of cases represented by advocates, with no requirement for voluntary contributions in mutuality. Learned AR maintained a clear identity between contributors and beneficiaries, and interest earned from bank-held amounts is also part of the fund as per the Welfare Act. Learned AR concluded that the fund, being capital in nature, should not be taxed, and all expenditures should be deductible, allowing net surplus and bank interest to be exempt from income tax based on mutuality principles.

24. Per contra, Learned DR argued that the principle of mutuality does not apply to the interest earned from Savings Accounts and Fixed Deposits because the banks contributing the interest are not the same as the advocates benefiting from it. Citing Hon'ble Supreme Court's decision in Bangalore Club vs. CIT, he submitted that such interest is commercial in nature and not exempt under mutuality. However, the Assessee's receipt of Life Membership Fees, Nomination Fees, and Certificate Fees from advocates was accepted under the principle of mutuality.

25. Learned DR further submitted that most of the contributions to the Fund come from Stamp sales, where advocates must affix Welfare Fund Stamps along with court fee Stamps on Vakalats. This requirement creates a lack of identity between contributors and beneficiaries, as not all contributors benefit from the fund. Moreover, the actual contributors are the advocates' clients, who reimburse the cost of the Stamps through legal fees, making the contributions commercial transactions rather than voluntary ones. Consequently, the income from Welfare Fund Stamps does not qualify for mutuality exemption due to its commercial nature and lack of voluntary contribution.

26. Learned DR also argued that income claimed under the State Act, is not exempt from tax since the State Act does not apply to the states listed in Schedule II, including the AP Advocates Welfare Fund Act, 1987. Further, learned DR submitted that expenditures claimed by the Assessee, such as Death Benefits, Financial Assistance, Funeral Expenses, Suspension of Practice, and Retirement Benefits, are not allowable under Section 37 or 57 of the IT Act, as they are considered applications of income rather than business expenses. Only Personal Costs and General Expenses were allowed as they directly relate to income generation. Consequently, the surplus amount was brought to tax.

27. Learned DR further agreed with the Learned Assessing Officer's decision to deny the exemption based on the principle of mutuality, highlighting Hon'ble Supreme Court's stance in Bangalore Club vs. CIT that there must be a complete identity between contributors and participants and that transactions should not be commercial. Learned DR noted that many contributors are not beneficiaries, and fees are often paid by clients rather than advocates, failing to meet the requirement of voluntary contributions. Therefore, the Learned Assessing Officer's decision may be upheld, as the transactions lacked the necessary voluntary character.

28. Learned DR supported the Learned Assessing Officer's argument against the exemption for welfare stamp sales, emphasizing that the sales were compulsory and paid for by clients, indicating commercial intent. This reinforced the lack of mutuality and voluntary nature in the transactions, leading to the dismissal of the Assessee's appeal.

29. Learned DR prayed to reject the Assessee's claim that all receipts and expenditures under the Welfare Fund Act should benefit advocates and qualify for mutuality-based exemption. The transactions were deemed commercial and business-oriented, disqualifying them from exemption under the principles of mutuality.

30. Lastly, Learned DR prayed to reject the claim of the assessee for exemption under section 23 of the Central Act, pointing out that the Advocates Welfare Fund Act 1987, listed in Schedule II of the 2001 Act, excludes the operation of the Central Act and section 23 thereof. Thus, the claim that all receipts are capital in nature and not taxable may be dismissed. Learned DR also argued that expenses such as death benefits, financial assistance, funeral expenses, suspension of practice, and retirement benefits are applications of income, not incurred exclusively for earning income, and thus not allowable under section 37 of the IT Act. Contending so, he prayed for the dismissal of the Assessee's appeal on these grounds.

31. We have gone through the record in the light of the submission made on either side. It could be seen from the above arguments on either side, assessee is challenging the impugned orders on several grounds like the jurisdiction of the learned Assessing Officer to examine the issue relating to the mutuality when the case is selected for the limited scrutiny to verify the deductions against the income; eligibility of the assessee to claim exemption basing on its status as local authority or instrumentality of state; applicability of the provisions of the Central act when both the Central and State Acts operate in the same space, by invoking the doctrine of the pregnancy; substantial compliance with the principles of mutuality on the ground that large number of participants are also contributors; statutory mandate, high the primacy of statutory objectives and legislative intent in determining the character and legality of an entity's operations justifying the application of mutuality in and implied manner etc., we shall now proceed to deal with all these aspects one after the other hereunder.

32. For the first time, in this appeal, the assessee argued that the case is selected only for limited scrutiny, and therefore, it should only limit to verifying "Deduction against Income" which are covered u/s 57 of the IT Act, but the learned Assessing Officer cannot blow it up to full scrutiny without obtaining the permission from the higher officers to consider issue

relating to the issue of mutuality. In our considered opinion, when an assessee, filing as a local authority, claims that their income is exempt from tax under the principle of mutuality, and the case is selected for scrutiny to examine the “deduction against income from other sources,” it presents a nuanced challenge, because the validity of the deductions claimed against income is inherently depending on understanding the nature of that income. It is not a case where the assessee claimed deductions under section 57 (iii) of IT Act, where the issue would be straight, and the learned Assessing Officer was not supposed into the income aspect. But when the deductions claimed against income are inherently depending on understanding the nature of that income, such an interconnection necessitates a careful and methodical approach by the learned Assessing Officer to consider the plea of mutuality to decide the deduction against such Income, because such examination of deductions against income from other sources requires verifying the legitimacy, documentation, and compliance of the deductions under IT Act. However, if the income is claimed to be exempt based on the principle of mutuality, the AO is duty bound to assess this claim to determine whether the deductions are applicable. It is so particular in this case that the deductions claimed by the assessee are not limited to the deductions permissible under section 57 (iii) of IT Act and such deduction is claimed by the assessee have a definite relationship with the plea of the assessee basing on the principle of mutuality. Examining the nature of deductions, because of their peculiar dependence on the nature of income, examination of the nature of income is imperative and it is implicit in the direction to verify the deductions against the income.

33. This nuanced situation created a scenario where the issues of deductions and the principle of mutuality overlap, making it essential to address both to arrive at an accurate assessment. This incidental examination is necessary to ensure that the deductions claimed are appropriate for the type of income being assessed. No doubt, initially, the

AO should focus on examining the deductions claimed against income from other sources. But this involves verifying the compliance with the relevant provisions of IT Act. When, during this process, it becomes imperative that understanding the nature of the income is essential to determine the validity of the deductions, the learned Assessing Officer has no other go except to examine the mutuality principle.

34. We, therefore, reach a conclusion that the interconnected nature of deductions and the principle of mutuality means that the learned Assessing Officer shall examine the issue of mutuality since directly impacts the evaluation of the deductions claimed. In this case, the requirement to verify the deduction against Income, is the implicit requirement that the learned Assessing Officer shall touch upon the mutuality issue to ensure accurate assessment of deductions. Since it is not possible to evaluate the deductions claimed, without examining the mutuality, and violation of mutuality principle is apparent on the face of provisions of Sections 15A and Section 15(1) of the State Act, learned Assessing Officer is justified in examining such an incidental issue also. Since the issue relating to the principal of mutuality is sine qua non for determining the issue of deductions claimed by the assessee, and such an issue does not require any in-depth examination, question of obtaining the permission of higher authorities does not arise. On this score, we reject the contention of the assessee.

35. Coming to the argument of learned AR as the status of the assessee being a Local Authority or an instrumentality of state, under Section 10(20) of the IT Act, a local authority is defined as a Municipal Committee, District Board, or similar Public Administrative Body with jurisdiction over a specific area. The Welfare Fund, governed by the Welfare Fund Committee, does not perform public administrative functions or possess jurisdiction over a geographical area, distinguishing it from entities considered local authorities under the Income Tax Act. We, therefore, find it difficult to accept the contention of the learned AR that because the fund

is managed by the appointees of the State Government and therefore, it is an instrumentality of State. Article 289(1) of the Constitution of India exempts the property and income of a State from Union taxation. The Welfare Fund Committee, though established by state legislation and comprising government representatives, functions autonomously and is not engaged in governmental activities. Decision of the Hon'ble Supreme Court in the case of *Ajay Hasia v. Khalid Mujib Sehravardi*, 1981 AIR 487, outlines the criteria to determine if an entity is an instrumentality of the State, and such criteria includes the financial support from the State and the extent of State control. The Welfare Fund, primarily funded by advocate contributions and managed independently, does not meet these criteria.

36. Turning to the main issue in this matter, the process of raising contributions to the Andhra Pradesh Advocates' Welfare Fund is comprehensively delineated in the State Act. Section 3 of the State Act mandates that the government, through a notification, constitutes the fund. Contributions to this fund are pooled from various sources specified in The State Act. Primarily, Section 12 of the State Act stipulates that every Vakalatnama or memorandum of appearance filed before any court must be affixed with a Welfare Fund Stamp valued at one hundred rupees. This requirement ensures assured contributions from practicing advocates. In terms of Section 3(2)(b) of the State Act, the Bar Council of Andhra Pradesh may make contributions to the fund. Voluntary donations from the Bar Council of India, any Bar Association, individual advocates, or any other persons are also credited to the fund under Section 3(2)(c) of the State Act. Government grants from both the Central and State Governments contribute to the fund as specified in Section 3(2)(d) of the State Act. The fund also accrues income from investments, with Section 3(2)(g) of the State Act directing that interest or dividends earned from such investments be credited back to the fund. Apart from this, application fees and annual subscriptions collected under Section 15 of the State Act, along

with any interest accrued on these amounts, form another significant source of revenue as outlined in Section 3(2)(h) of the State Act.

37. In raising the Welfare Fund and its subsequent expenditure, two distinct classes of contributors emerge: those entitled to benefits and those who are not. The first class includes contributing advocates who are members of the fund and thereby entitled to its benefits. Section 15(1) of the State Act states that advocates below the age of thirty-five, practicing in any court in the state, and who are members of a recognized Bar Association, may apply for admission to the fund. Upon payment of an admission fee and an amount for life membership, these advocates, as detailed in Section 15(5)(a) of the State Act, become eligible for various benefits. The Welfare Fund Committee, established under Section 4, administers the benefits, which include payments upon cessation of practice as per Section 16(1), group insurance policies according to Section 18(a), provident fund policies under Section 18(b), medical facilities for members and their spouses as stated in Section 18(c), and other prescribed benefits.

38. Conversely, the second class consists of contributing advocates who are not entitled to the fund's benefits. These advocates contribute under the compulsion of mandatory Welfare Fund Stamp required by Section 12 of the State Act, but cannot apply for and cannot be admitted as members of the fund, because of which they do not receive the benefits outlined in The State Act. This creates a statutory compulsion where all advocates contribute to the fund, but only those who are members as per Section 15 are entitled to benefits.

39. The statutory compulsion for non-beneficiary advocates to contribute to the fund raises the significant question regarding the principle of mutuality. The principle of mutuality is fundamentally based on a group of individuals contributing to a common fund for mutual benefit, with no external or commercial elements. Benefits are intended

to be returned to the contributors or their dependents. The mandatory contributions from non-beneficiary advocates, however, introduce an external element, as some contributing advocates referred in Section 15A of the State Act do not receive reciprocal benefits. This statutory requirement, as enforced by Section 12 of the State Act, mandates all advocates to affix a Welfare Fund Stamp on their Vakalatnama, regardless of their membership status in the fund.

40. From the viewpoint of mutuality, this statutory compulsion challenges the core principle. Mutuality is based on the idea that contributors to a fund are the same individuals who benefit from it. The inclusion of non-beneficiary contributors disrupts this balance, as it creates a scenario where some contributors do not receive any benefits in return for their contributions. This undermines the mutuality principle, as the fund includes contributions from individuals who are not part of the mutual benefit group. The statutory scheme, as outlined in the Andhra Pradesh Advocates' Welfare Fund Act, 1987, therefore, presents a conflict with the mutuality principle by enforcing contributions from non-beneficiary advocates.

41. In these appeals we are, therefore, called upon to examine this significant question as to whether such a statutory requirement adheres to the principle of mutuality, as the mandatory contributions from non-beneficiary advocates could be seen as incompatible with the fundamental idea of mutual benefit. The statutory framework must be assessed to ensure it upholds the mutuality principle and provides a fair and just mechanism for all contributing advocates.

42. The principle of mutuality is predicated on the fundamental requirement of complete identity between contributors to a common fund and the beneficiaries of that fund. Hon'ble Supreme Court of India has consistently upheld this principle, emphasizing that any breach of this identity results in the transactions assuming a commercial character,

thereby making the surplus taxable. This position has been reinforced in several landmark rulings.

43. In *Chelmsford Club vs. CIT*, (2000) 243 ITR 89 (SC), Hon'ble Supreme Court underscored the necessity of a reciprocal relationship where all contributors to a fund must also be beneficiaries of the surplus. The Court held that if contributors are excluded from receiving benefits, the principle of mutuality is breached, and the resulting surplus is taxable. This decision highlighted that mutuality requires a strict identity between contributors and participants, and any deviation from this identity transforms the nature of the transactions from mutual to commercial.

44. In *Commissioner of Income Tax, Bihar vs. Bankipur Club Ltd.*, (1997) 5 SCC 394, the Hon'ble Court held that income derived from transactions involving non-members or from the activities in the nature commercial activities does not qualify for mutuality. The ruling emphasized that the absence of identity between contributors and beneficiaries converts the surplus into taxable income. This judgment reinforced the notion that mutuality is strictly confined to activities within the mutual entity where contributors and beneficiaries are the same.

45. Such a principle was again reaffirmed in *Bangalore Club vs. Commissioner of Income Tax*, (2013) 5 SCC 509, where Hon'ble Supreme Court held that interest income earned from fixed deposits in banks by clubs is taxable. The involvement of third parties, such as banks, breaches the mutuality principle, making the income derived from such transactions taxable. This decision reiterated that mutuality applies only to transactions within the mutual entity and does not extend to dealings with external parties.

46. The question of whether the statutory provision allowing benefits only to members while extracting contributions from non-members could invoke the principle of mutuality was also considered. Even where a statute

mandates such provisions, the principle of mutuality cannot be invoked because the fundamental requirement of identity between contributors and beneficiaries is breached. Hon'ble Supreme Court has emphasized that the mutuality principle requires complete reciprocity and identity between contributors and participants. When this identity is absent, as in cases where non-members are compelled to contribute but are excluded from benefits, the transactions assume a commercial nature, making the surplus taxable.

47. The argument advanced by the learned AR that a statute's provisions override this requirement and allow benefits only to members is not convincing. Hon'ble Supreme Court's rulings in Chelmsford Club vs. CIT, Bankipur Club, and Bangalore Club made it clear that any breach of the identity between contributors and beneficiaries transforms the transactions into commercial ones, subjecting the surplus to taxation. Thus, the statutory mandate allowing benefits only to members while compelling contributions from non-members would not suffice to invoke the principle of mutuality and exempt the surplus from tax.

48. The Hon'ble Supreme Court of India in Yum! Restaurants (Marketing) Private Limited vs. CIT (2020) 424 ITR 630 provided a detailed analysis of the doctrine of mutuality, particularly emphasizing the necessity for complete identity between contributors and participants or beneficiaries and held that this principle is central to determining the taxability of surplus under IT Act.

49. Hon'ble Court held that the doctrine of mutuality is grounded in the fundamental idea that an entity cannot trade with itself. This principle dictates that if the identities of the seller and the buyer, the vendor and the consumer, or the contributor and the participant are identical, then a profit motive cannot be attributed to such transactions, because of which any surplus remaining with such an entity cannot be considered taxable income under IT Act. For income to be taxable, it must arise from

commercial exchanges between distinct entities. In *Yum! Restaurants (Marketing) Private Limited (supra)*, Hon'ble Supreme Court referred to several landmark cases to substantiate this principle. The Court noticed the decision in *Commissioner of Income Tax, Bihar v. Bankipur Club Ltd.* (1997) 5 SCC 394, which held that surpluses generated by members' clubs from services rendered to their members do not constitute taxable income due to the principle of mutuality. Similarly, in *Bangalore Club v. Commissioner of Income Tax & Anr.* (2013) 5 SCC 509, the Court reinforced this principle by quoting *New York Life Insurance Co. v. Styles* (1889) 2 TC 460, which stated that contributions returned to members should not be regarded as profits.

50. Hon'ble Court outlined three essential conditions for mutuality, which have been well-established in prior case law and academic works. These conditions were derived from *English and Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of Agricultural Income-Tax, Assam* (AIR 1948 PC 142) and reaffirmed in *Commissioner of Income Tax, Bombay City v. Royal Western India Turf Club Ltd.* (AIR 1954 SC 85). First, there must be an identity of contributors and recipients, meaning the contributors to the fund and the recipients from the fund must be the same. Second, the entity should function as a mere instrument for the convenience of its members, adhering to their mandate. Third, it must be impossible for contributors to derive profits from contributions made by themselves.

51. Hon'ble Supreme Court emphasized that the principle of mutuality necessitates that all contributors to the common fund must be entitled to participate in the surplus, and all participants in the surplus must be contributors. This ensures a homogeneous class with no external commercial elements interfering. The Court further referenced its earlier ruling in *Bankipur Club*, where it was held that if an entity engages in transactions with both members and non-members, the transactions lose their mutual character and become commercial. Similarly, in *Royal*

Western India Turf Club (*supra*), the Court held that money realized from both members and non-members for the same activities disqualifies the entity from claiming mutuality.

52. Hon'ble Court also cited the British Tax Encyclopaedia (1962 Edition), which states that for the doctrine of mutuality to apply, all contributors to the common fund must be entitled to participate in the surplus, and all participants in the surplus must be contributors. This ensures that there is no interference of any alien commercial entity in the transactions.

53. Ultimately, Hon'ble Supreme Court concluded that the assessee company did not fulfil the conditions of mutuality, particularly the requirement of complete identity between contributors and participants. Therefore, it could not claim exemption from tax liability. The doctrine of mutuality, which provides special tax exemption status, must be strictly interpreted, and any failure to meet its stipulations disqualifies the entity from tax exemption.

54. Basing on the facts of that case, the Court found that while Pepsi Foods Ltd. was a contributor, it was not a beneficiary of the surplus. Pepsi Foods Ltd. was not a franchisee and thus had no right to receive back any surplus. This lack of entitlement of Pepsi Foods Ltd. to participate in the surplus breached the principle of complete identity. The Court noted that the assessee company failed to maintain this complete identity. Although Pepsi Foods Ltd. was a contributor, it was not entitled to participate in the surplus as it was not a franchisee. This breach in the principle of complete identity led to the conclusion that the transactions had a commercial nature. Thus, the Court observed that the assessee company was realizing money from both members and non-members, such as Pepsi Foods Ltd., in the same activity. This duality of transactions breached the complete identity requirement and tainted the operations with commerciality. Consequently, the surplus was deemed taxable. The Court also addressed

the contention that Pepsi Foods Ltd. indirectly benefited from the mutual operations through exclusive contracts with franchisees. It held that such indirect benefits do not fulfil the requirement of mutuality as Pepsi Foods Ltd. was not a member of the mutual concern. In summary, the Hon'ble Supreme Court in Yum! Restaurants (Marketing) Private Limited vs. CIT (2020) 424 ITR 630 reinforced the principle that mutuality requires a complete identity between contributors and participants. The involvement of non-members, such as Pepsi Foods Ltd., in the transactions broke this identity, rendering the operations commercial and the surplus taxable. The Court's detailed examination and reliance on multiple case laws underscore the strict interpretation of mutuality required to claim tax exemption.

55. Coming to the facts of the case on hand, the doctrine of mutuality, which suggests that no person can trade with themselves, is breached when contributors to a common fund do not receive proportional benefits or when an entity operates with a profit motive. The Andhra Pradesh Advocates' Welfare Fund Act, 1987, inherently breaches mutuality by creating two classes of contributors: members and non-members. Members, who apply and are admitted to the Fund, are entitled to various benefits, while non-members are excluded. This differentiation disrupts the principle of mutuality, as not all contributors to the welfare mechanism receive reciprocal benefits.

56. No doubt, the Welfare Fund's structure does not align with typical commercial entities, as it is intended for the welfare of advocates rather than profit generation, but, at the same time, the differential treatment of advocates and the Fund's independent financial operations suggest a quasi-commercial character. Under Section 10 of the State Act, the Fund engages in activities like borrowing and investment, which are characteristic of commercial enterprises. Although these activities are for welfare purposes, the financial autonomy and the ability to generate

income from various sources, namely, donations, investments etc., impart a commercial aspect to the Fund's operations.

57. Despite the statutory mandate and high the primacy of statutory objectives and legislative intent in determining the character and legality of an entity's operations, given the patent breach of mutuality, in the light of various decisions of Hon'ble apex court referred to above, the Fund is not entitled to the exemption on the ground of mutuality.

58. Learned AR submitted that the Central Act provides under section 23 thereof that the profits or gains, the income accrued to the Fund constituted under sub-section (1) of section 3 shall be exempt from Income-tax, and since the Central and State Acts operate in the same space, the provisions of Central Act shall be given effect to. We don't find any substance in this submission to invoke the doctrine of repugnance in this matter.

59. The doctrine of repugnance, as outlined in Article 254 of the Indian Constitution, addresses conflicts between laws passed by both the Central and State legislatures. This doctrine is typically invoked when a State law is repugnant to a Central law, necessitating the determination of which law prevails. According to Article 254(1), if a State law is repugnant to a Central law, the Central law prevails, and the State law becomes void to the extent of the repugnancy. However, Article 254(2) allows a State law to prevail in that State if it has received the President's assent, although Parliament can subsequently override such State law.

60. The application of the doctrine of repugnance is not required when a Central Act explicitly states that it will not apply where there is a State legislation on the same subject. Such a clause in the Central Act indicates an acknowledgment of the possibility of State legislation and a decision to defer to it. This self-exclusion clause in Section 38 of the Central Act inherently resolves potential conflicts by stating the non-application of the

Central Act in the presence of State law, thereby precluding the need for the doctrine of repugnance.

61. In the case of *Deep Chand vs. State of U.P.* (1959) SCR 8, the Supreme Court of India held that for the doctrine of repugnance to apply, there must be a clear and direct inconsistency between the Central and State Acts, making it impossible for both to operate concurrently, and no possibility of reconciling the two laws. Similarly, in *M. Karunanidhi vs. Union of India*, (1979) 3 SCC 431, the Supreme Court outlined tests to determine repugnance, including the presence of direct conflict, Parliament's intention to lay down an exhaustive code, whether both laws occupy the same field, and whether they can stand together.

62. When a Central Act explicitly states its non-application in areas where there is State legislation on the same subject, the invocation of the doctrine of repugnance is unnecessary. The Central Act's provision for its own non-application in the presence of State law avoids any conflict, thus negating the need for Article 254 to be applied.

63. We, therefore, hold that the doctrine of repugnance does not apply when a Central Act contains a clause that excludes its application where State legislation exists on the same subject. This clause demonstrates a clear legislative intent to defer to State law, effectively resolving potential conflicts and making the invocation of the doctrine of repugnance superfluous.

64. Now coming to the argument that the Andhra Pradesh Advocates' Welfare Fund Act, 1987, provides an overriding title for spending funds for the objectives of the Fund, it requires a little deep analysis of the provisions of the State Act. A reading of the State Act shows that it constitutes the Andhra Pradesh Advocates' Welfare Fund to support the welfare of advocates in Andhra Pradesh. According to Section 3 of the State Act, the Fund is comprised of various receipts, including amounts paid under

Section 12, contributions from the Bar Council, voluntary donations or contributions from various sources, grants from the Central or State Government, borrowed sums under Section 10, profits, dividends, interests, and other returns from investments, and sums collected as application fees and annual subscriptions. Application and management of these receipts delineated under Sections 3, 8, 9, and 10. Section 3(2), though explicitly list the sources of receipts to be credited to the Fund, do not confer an overriding title to spend these funds directly. On the other hand, it is stipulated that these sums are to be credited to the Fund and subsequently managed and applied as per the provisions of The State Act.

65. We shall now deal with such an aspect in a detailed way. Section 8 of the State Act clarifies the vesting and application of the Fund and it states that the Fund shall vest in and be held and applied by the Welfare Fund Committee subject to the provisions and purposes of the State Act, thereby indicating that the Committee is responsible for managing the Fund according to the specific rules and regulations set forth by the State Act, rather than having an overarching authority to spend at will. Likewise, Section 9 of the State Act delineates the functions of the Committee in administering the Fund, and such functions include holding the amounts and assets, processing applications for membership, disbursing payments to members or their dependents, maintaining accounts, and other administrative tasks, and the Committee must follow the rules prescribed under The State Act while performing these duties. In the same way, Section 10 of the State Act allows the Committee, with the prior approval of the Bar Council, to borrow funds for the purposes of The State Act, all moneys and receipts forming part of the Fund are to be deposited in nationalized banks, and all expenditures related to the management and administration of the Fund are to be paid from it.

66. A combined reading of these sections clearly shows that the scheme and framework of the State Act reinforces that expenditures are application of received funds, conducted in a structured and regulated

manner, but does not grant an overriding title to any authority to spend the funds without leaving any discretion to the Committee. On the other hand, it mandates the collection, management, and application of receipts through a structured process governed by the Welfare Fund Committee, ensuring that all actions are within the framework of the State Act. We, therefore, hold that the State Act does not provide an overriding title for spending funds for the objectives of the Fund, but rather outlines the application of receipts after they are received.

67. Learned AR stressed much on the statutory objectives and legislative intent of the Andhra Pradesh Act, stating that when the assessee is discharging the statutory obligations under the State Act, it is not reasonable to fasten tax liability on the surplus funds, which are meant for application towards the statutory objects. In the framework of Income Tax Act, exemption provisions are conditional upon adherence to the mutuality principle and fulfilment of requirements set forth in Sections 11 and 12A thereof. Conversely, assessee claims exemption similar to the one in Section 23 of the Central Act, without resolving the conflict due to the violation of the mutuality principle. The State Act is not aligning itself with the Central Act where there is no violation of mutuality principle in respect of the participants and beneficiaries. Because of glaring breach of mutuality principle, despite the statutory objectives and legislative intent of the Andhra Pradesh Act, it cannot override or encroach upon the domain of central legislation concerning taxation. We accordingly find it difficult to accept the contention of the assessee.

68. For the reasons recorded in the foregoing paragraphs, we are of the considered opinion that the impugned orders do not suffer any illegality or irregularity, and therefore, we uphold the same. Consequently, the appeal is found devoid of any merits and dismissed.

69. In view of the identical facts, question of law and contentions in the appeals for the assessment years 2017-18 and 2018-19, the findings in the

appeal for the assessment year 2016-17 is applicable on all fours, for these two years also. Following the same, we dismiss the appeals for the assessment years 2017-18 and 2018-19.

70. In the result, all the three appeals of the assessee are dismissed.

Order pronounced in the open court on this the 24<sup>th</sup> day of July, 2024.

Sd/-  
**(MADHUSUDAN SAWDIA)**  
**ACCOUNTANT MEMBER**  
Hyderabad,  
Dated:24/07/2024

Sd/-  
**(K. NARASIMHA CHARY)**  
**JUDICIAL MEMBER**

Pvv/SPS

Copy forwarded to:

1. Andhra Pradesh Advocates Welfare Fund, High Court Building, AP High Court Road, High Court S.O (Hyderabad) Charminar, Hyderabad 500066
2. The Income Tax Officer, Ward-2, Hyderabad.
3. The Pr.CIT, Hyderabad
4. DR, ITAT, Hyderabad.
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