**Commissioner of Income-tax Vs. Darjeeling Club Ltd.**

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**Court** : Kolkata

**Decided On :** Jan-19-1984

**Reported in** : (1984)42CTR(Cal)338,[1985]153ITR676(Cal)

**Judge** : S.C. Sen and ;U.C. Banerjee, JJ.

**Acts** : Income Tax Act, 1961 - Section 22

**Appeal No.** : Income-tax Reference No. 522 of 1975

**Appellant** : Commissioner of Income-tax

**Respondent** : Darjeeling Club Ltd.

**Judgement** :

Suhas Chandra Sen, J.

1. The two following questions of law have been referred to this court by the Tribunal under Section 256(1) of the I.T. Act:

'1. Whether, on the facts and in the circumstances of the case, the Tribunal was correct in holding that the receipts of the assessee from the temporary and the honorary members on account of messing charges, for subscriptions and games could not be assessed to tax in its hands as income derived from a business ?.

2. Whether, on the facts and in the circumstances of the case, the Tribunal was right in holding that the income derived from rooms occupied by the members, permanent, temporary and honorary could not be assessed as income from property in the hands of the assessee ?'

2. The assessment years are 1965-66 to 1970-71. The assessee is the Darjeeling Club Ltd. It was incorporated as a company limited by guarantee. It has three classes of members, viz., (1) permanent, (2) temporary, and (3) honorary. The latter two classes of members are also entitled to the same privileges which the permanent members are entitled to except that they can neither vote nor can be elected nor be co-opted to any committee. It has a set of rooms fully furnished which are let out to the members. It provides refreshments and meals to the members and their guests. It has also a bar where drinks are supplied to the members and their guests. The club charges for refreshments, meals and drinks supplied and also charges rent for the rooms.

3. Before the ITO, the case of the assessee was that the club was a mutual concern and the surplus accruing to it could not be regarded as income. It was further urged that there could not be any difference between the permanent and the temporary members as all the members enjoyed the same benefits and were contributors and participators. The ITO was of the view that if some of the contributors to the funds were not participators in the surplus or if some of the participators in the surplus were not contributors to the common fund, the profit of theassociation would be assessable to tax. He found that the tourists who were taken as

temporary members were contributors, but they were not participators in the surplus. He held that the temporary members did not even participate in the surplus created on account of their own stay, not to speak of participating in the surplus of the club. Thus, he held that the income from the receipts from the temporary members was taxable. He found that there was no rational basis for allocating only small fraction of food and lodging charges received from the guests for stay to the dormitory account. The ITO allocated 60 per cent. of the charges both from the permanent and temporary members for messing and 40 per cent. for lodging. He further held that the profit attributable to the receipts from the temporary members should be taxed; The income from dormitory account was considered by him under the head 'Income from house property'. Thus, 40 per cent. of the charges from both the permanent and temporary members were taken as income from property and after allowing statutory deduction, he taxed the balance. He also taxed 60 per cent. of the charges received from the temporary members as business income.

3. The assessee preferred appeals before the AAC. The AAC held that the income of the club had to be computed by including (i) profits and realisations received from the temporary and special members, (ii) income from premises let out to the hospital, and (iii) income from dividend and securities.

4. The assessee as well as the ITO preferred appeals to the Appellate Tribunal. The Tribunal held that the club provided facilities to its members by supplying food, refreshments and beverages on payment. The supplies made to its members by the club could not be treated as sales. The club did not trade with its members. The club was not a trading association. The permanent, temporary and honorary members were contributors to the common fund. The supplies were not made by the club to any outsiders. The surplus available by overcharging the members could not be treated as profit. The assessee club formed by the members for recreation and other activities cannot be considered to trade for profit. The club did not really carry on any business with its members in order to earn any profit and the surplus of the receipts from the members over the expenditure could not be treated as profit. Thus, the Tribunal held that the receipts from the temporary and honorary members were not trade transactions and no income arose from such transactions in order to tax the same. It was further held that even the income from providing lodging to temporary, permanent and honorary members could not be treated as commercial transaction and no income from such receipts could be treated as income from property. It was also held that the charges for lodging were in no way different from the charges recovered for the supplies of refreshments and meals to the members. The dealings by the club being exclusively with the members, the receipts for lodging also could not be treated as income falling either under the head 'Other sources' or 'Income from property'.

5. The Tribunal further held that the income from the receipts both from lodging, as well as messing, bar, etc., from the permanent, temporary and honorary members could not be assessed to tax. The Tribunal was of the view that the charges for lodging were in no way different in character from the charges for supply of meals and other refreshments.

6. This case has now come up before us on reference at the instance of the Revenue. Although the points of law raised in this case are fairly well settled, the case has been argued at great length by Mr. Bagchi, appearing on behalf of the Revenue.

7. There is a long line of decisions in which it has been held that supplies made by a club to its members or the facilities afforded by a club to its members for a price will not amount to business activity of the club, even though there may be surplus of revenue over expenditure and the surplus could not be taxed as business profits if the sales were confined to the members of the club only. Mr. Bagchi has contended that this principle will not apply to the facts of the case before us. The club in the instant case is a company incorporated under the Companies Act. Therefore, it has got a legal personality quite distinct and separate from its members. It has sold goods and services to the members. The principle that a man cannot make profit out of himself cannot apply to a club which has been incorporated as a company under the Companies Act.

8. His second contention is that there are some temporary and honorary members of the club and the profits arising out of sales to those persons must be taxed as income of the company. There is no reason to place the honorary and temporary members in the same category as the permanent members. Any profit arising out of business done with the honorary and temporary members must be taxed as business profit.

9. The third contention of Mr. Bagchi is that the income that was derived from providing accommodation to the members has to be assessed under the head 'Income from house property'. According to him, the ITO was right in levying tax on that part of the income which was attributable to letting out of the rooms as income from property. Even though it was a club and even if it be held that it was not carrying on any business, the assessee was liable to pay tax on the annual letting value of the property owned by it.

10. So far as the first question is concerned, the point has been gone into and decided as early as in the case of New York Life Insurance Co. v. Styles [1889] 14 AC 381; 2 TC 460. That case has been followed and explained in a number of judgments. It is too late in the day to argue that a club which is incorporated as a company has a personality separate and distinct from the members and, therefore, sales of goods and services to the members will amount to business activity of the company with another person and, in the eye of law, it is earning profit just as an ordinary tradesman by selling goods to his customers makes profits.

11. The principles laid down in the decided cases may be briefly stated. A group of persons can form a club to provide some facilities to themselves and any excess payment for these facilities may be retained for future use. In this process, no profit is made. When these persons form themselves into a company and arrange their affairs in such a way that the company makes profit for and on behalf of the members, it has got a distinct and separate personality from the members in the eye of law, but the members are using the company and the corporate personality for obtaining goods and services. The surplus that the company gets is held on behalf of the members and for future use of the members. The members may get it back either in the shape of reduction of price or extension of facilities that are to be provided to the members in future. The important point is that the company is not acting as a business concern or a trading company on its own for the purpose of making gain. The company is being used by the members for the purpose of obtaining goods and services as their agent. A company can make profit out of its members when members are treated as customers. Where, however, all that a company does is to collect money from a certain number of people and retain the surplus fund for the benefit of those people not as shareholders of the company but as people who subscribed to it or paid for it, then 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 corporate entity of the company is to be disregarded, but because there is no accrual of profit, the money is simply collected from the members and held on their behalf, not in the character of shareholders but in the character of those who have paid for it. The excess that is realised from the members will be used for the benefit of the members in some form or other.

12. Lord Cave in the case of Jones v. South-West Lancashire Coal Owners' Association Ltd. [1926] 11 TC 814, at p. 839; repelled a similar contention in the following words :

'It was argued that this view gives no effect to the well-established distinction between a company and its members, and that, although the members may make no profit, a profit may still accrue to the company. The same point arose in the New York Life's case [1889] 2 TC 460 and was disposed of in the speeches of Lord Herschell and Lord Macnaghten. Lord Herschell, after stating that the Attorney-General (who in that case appeared for the Revenue authorities) had conceded that the fact that the persons associating themselves together for the purpose of mutual assurance had been incorporated was immaterial, and that the case might be treated as though it were an association of individuals unincorporated, added : 'I think the Attorney-General was correct in thinking it immaterial that the persons thus associated had been incorporated, and that a legal entity had been created distinct from the members of which it was composed. This being so, I shall, for the sake of simplicity, consider the questions that arise as though the association were unincorporated.''

13. Lord Macnaghten dealt with the same point as follows (2 TC 460, 483) :

'It happens here that the persons who combined to obtain the benefit of mutual insurance became, by the very act of insuring their lives, members of an incorporated company. But the company (so far as regards the participating policyholders) was not formed for the purpose of carrying on a business having for its object the acquisition of gain... The fact, therefore, that the insured, who are also the insurers, carry on their business through the medium of a company was properly treated as immaterial.'

14. It appears to me that the reasoning which commended itself to those distinguished jurists in the New York Life's case [1889] 14 A. C 381 applicable as it is to genuine mutual concerns and to no others, applies to the present case, and disposes of the contention now under discussion.

15. Lord Cave also in that judgment pointed out that the surplus fund of the company, sooner or later, in meal or in malt, must go back to the policyholders as a class, though not precisely in the proportions in which they had contributed to them and the association did not in any true sense make a profit out of their contributions. Mr. Bagchi has referred to the memorandum of association and has argued that the company was formed for the purpose of doing business. This argument also does not carry the matter any further. The company may do business with outsiders for gain but the business in the instant case is confined to the members only. It has acted as an agency of the members for and on their behalf for providing goods and services to the members as a class. Any excess fund is to be kept in hand for future use of the members for providing better amenities to them.

16. The fact that there are some temporary members and some honorary members is quite immaterial. The class of members may diminish or may increase. Some members may retire, some members may die but the class of the members who contribute to the fund remain as a class the same. This aspect of the matter was emphasised by Lord Upjohn in the case of Faulconbridge (H. M. Inspector of Taxes] v. National Employers' Mutual General Insurance Association Ltd. [1952] 33 TC 103:

'Finally, viewed in the light of the other cases, I think it is clear that when Lord Macmillan speaks of the cardinal requirement being complete identity between the contributors and the participators, he is not referring to individual identity but to identity as a class, so that at any given moment of time, the persons who are contributing must be identical with the persons who are entitled to participate; whereas it follows, in my judgment, that it matters not that the class has been, diminished by persons going out of the scheme or that others may come in in their place in the future.'

17. Therefore, it is not necessary that the members who contribute to the funds of the club must be the identical persons who enjoy the benefit of the excess contribution. What is important is that the members as a class will be entitled to the benefit. The temporary and the honorary members have enjoyed the facilities of the club as members. They have contributed to the funds as members. Any surplus contribution will be held for the benefit of the members. To adopt the phrase used by Lord Cave, sooner or later, in meal or in malt, the benefit of the surplus fund must go back to the members as a class, though not precisely in the proportions in which they have individually contributed to the surplus fund. The fact that the temporary or honorary members may go out of the scheme or other new members may come in will not make any difference to the principle. The surplus that was made out of the dealings and transactions with the members of the club will be retained for the benefit of the members as a class.

18. In the case of United Services Club v. Emperor, AIR 1921 Lah 208, Martineau J. held that the money received by a club from its members could not be properly regarded as its 'income'. The fact that the club was incorporated as a company -did not make any difference.

19. This point came up very recently for consideration in the case of CIT v. Bankipur Club Ltd. : [1981]129ITR787(Patna) . In that case, the club had permanent, temporary as well as ordinary members. The question was whether the club which was formed for social intercourseand for either recreation or for

cultural activities could be considered to trade for profit so as to make its surplus taxable in law when it overcharged its members for the supply of refreshments, beverages or drinks. A Division Bench of the Patna High Court held there could not be any profit so far as the transaction of sale of drinks was concerned. The club was owned by the members and so the transaction would amount to a sale by the members to themselves. All the members were entitled to participate in this privilege and the income arising therefrom was applied for repurchasing drinks or for providing further privileges to the members. The profits were, therefore, entitled to exemption on the doctrine of mutuality.

20. The Andhra Pradesh High Court in the case of CIT v. Merchant Navy Club : [1974]96ITR261(AP) was also of the view that supplies made by a club to its members did not amount to sale for profit. On a construction of the articles of association of the club, the Andhra Pradesh High Court held that the registration of the club as an association under the Societies Registration Act did not affect the nature of the transactions or the taxability of the surplus. The club in all such cases was only acting as an agent of the members for making supplies to the members.

21. Mr. Bagchi strongly relied on a decision of the Supreme Court in the case of CIT v. Royal Western India Truf Club Ltd. : [1953]24ITR551(SC) , and also on the judgment of a Division Bench of the Bombay High Court in the case of Royal Western India Turf Club Ltd. v. CIT : [1970]78ITR548(Bom) . In these two cases, the club in question was the Royal Western India Truf Club Ltd. The objects for which the club was incorporated were, inter alia (at p. 553 of 24 ITR):

'(a) To take over the assets, effects and liabilities of the then unincorporated club known as the Western India Turf Club ;

(b) to carry on the business of a race course company in all its branches..... ;

(c) to establish any clubs, hotels and other conveniences in connection with the property of the company;

(d) to carry on the business of hotel-keepers, tavern-keepers, licensed victuallers and refreshment purveyors ;

(e) to sell, improve, manage, develop, lease, mortgage, dispose of or otherwise deal with all or any part of the property of the company, whether movable or immovable, with power especially to sell and distribute or to permit to be sold and distributed wines, spirits, tobacco and other stores.'

22. The club was not acting as an agent of the members for the purpose of providing facilities and supplies to the members only. The club was acting as a business organisation and had dealings and transactions with the members as well as non-members. It is true that some of the facilities were strictly reserved for the members but it could not be said that the facilities of the club were for the members only. The Supreme Court emphasised this aspect of the matter at p. 560 (of 24 ITR) after referring to Styles' case (2 TC 460) in the following words:

'Where a company collects money from its members and applies it for their benefit not as shareholders but as persons who put up the fund, the company makes no profit. In such cases, where there is identity in the character of those who contribute and of those who participate in the surplus, the fact of incorporation may be immaterial and the incorporated company may well be regarded as a mere instrument, a convenient agent for carrying out what the members might more laboriously do for themselves. But it cannot be said that incorporation which brings into being a legal entity separate from its constituent members is to be disregarded always and that the legal entity can never make a profit out of its own members. What kinds of business other than mutual insurance may claim exemption from tax liability under Section 10(1) of the Act under the principles of Styles' case need not be here considered ; it is clear to us that those principles cannot apply to an incorporated company which carries on the business of horse racing and realises money both from the members and from non-members for the same consideration, namely, by the giving of the same or similar facilities to all alike in course of one and the same business carried on by it.'

23. In fact, the ITO himself held that the amount collected from the permanent members which was in excess of the cost was not taxable as business income. The ITO, however, held that the excess was to be taxed as business income only to the extent it was realised from the honorary members and the temporary members. But as has been noted earlier in the judgment, this distinction is not very material because the exemption is granted not on the basis of the identity of the persons who are making the contributions and getting the benefit of the excess contribution. The members are contributing as a class and are getting the benefit of the excess contribution as a class. The class may be a fluctuating class, but none the less remains as a class of members of the club. They are not getting dividend out of the profits, but the profits are being kept in reserve for the use and the benefit of the members as a class in future.

24. Reliance was also placed in the case of Indian Tea Planters' Association v. CIT : [1971]82ITR322(Cal) , a Bench decision of this court. There, the assessee derived income from procuring foodgrains from the Government and selling it to the labourers. It was clearly not a case of dealing and transaction amongst the members of the club only. It was an ordinary business transaction and so this was held to be taxable.

25. Reference may also be made to the decision of the Supreme Court in the case of Joint Commercial Tax Officer v. Young Men's Indian Association : [1970]3SCR680 . In that case, the Supreme Court held that when the club was acting as an agent of the members, there was no sale and the club was not liable to sales tax. The Supreme Court pointed out that what was essential was that the holding of the property by the agent or trustee must be a holding for and on behalf of and not a holding antagonistic to the members of the club. Although the decision was made under the Sales Tax Act, the principle will also apply to the case before us.

26. We are of the view that in the facts of this case, the club was not carrying on any business with its members and the Tribunal was right in holding that the surplus derived from sale of goods and services to the members could not be taxed as business income of the club.

27. The third point of Mr. Bagchi is also without any substance. When the club provides accommodation to its members, it provides bed, light and many other facilities. The members enjoy the facilities not as tenants but as members of the club. It cannot be said that the members are paying rent and have, therefore, become tenants of the club during their stay. What is supplied by the club to the members is a composite of many things. Under Section 22 of the I.T. Act, income from house property is liable to be taxed. The income that the club has made in this case is not from letting out of the rooms. The income is derived from providing many facilities to the members including accommodation. Neither the club nor the members have treated these facilities separately and the Department cannot also treat them separately by splitting up the facilities under various heads.

28. Apart from this, the basic difficulty in the way of the Income-tax Department is that the facilities including accommodation were provided by the club as agent of the members and not as owner of the house property. The members have provided for themselves these facilities through the instrumentality or agency of the club. The club was not the landlord and the members, during their stay, were not the tenants of the club. The members by virtue of their membership were entitled to avail of the facilities of the club as of right according to the rules of the club. They were entitled to accommodation also as of right. What is paid by the members for their accommodation cannot be treated as rent and that income cannot be regarded as income from house property under the I.T. Act.

29. Reliance was placed on behalf of the Revenue on the case of CIT v. Wheeler Club Limited : [1963]49ITR52(All) . In that case, a Division Benchof the Allahabad High Court hold that the principles of mutuality did not apply when there was letting out of rooms to the members. The point came up for consideration once again before the Allahabad High Court in the case of CIT v. Cawnpore Club Limited : [1984]146ITR181(All) . In that case, the earlier Allahabad judgment in Wheeler's case was distinguished and it was held that the income was not taxable because the principle of mutuality applied.

30. A Division Bench of the Madras High Court in the case of Presidency Club Ltd. v. CIT [1981] 127 ITR 264 has

also held that the rental income derived by a members' club for providing accommodation to members, their families and friends were not liable to tax on the basis of the principle of mutuality.

31. In view of the aforesaid, both the questions are answered in the affirmative and against the Revenue.

32. Each party to pay and bear its own costs.