REPORTABLE

2023INSC736

IN THE SUPREME COURT OF INDIA
CIVIL APPELLATE JURISDICTION

CIVL APPEAL NO(S). 5195-5201 OF 2012

SECUNDRABAD CLUB ETC. **APPELLANT(S)**

VS.

C.I.T.-V ETC. **RESPONDENT(S)**

WITH

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 19976 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 1119 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 16817 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 16819 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 16818 OF 2011)

CIVIL APPEAL NOS._____ OF 2023
(@ SLP (C) NO(S). 5109-5116 OF 2010)

CIVIL APPEAL NO(S)._____ OF 2023
(@ SLP (C) NO(S). 6263-6266 OF 2010)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 4347 OF 2010)

CIVIL APPEAL NO(S).____ ____ OF 2023
(@ SLP (C) NO(S). 12897-12900 OF 2010)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 30957 OF 2010)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 30958 OF 2010)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO.13806 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 1368 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 1941 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 1256 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 1346 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 13986 OF 2011)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 34130 OF 2009)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 30960 OF 2010)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 30959 OF 2010)

CIVIL APPEAL NO._____ OF 2023
(@ SLP (C) NO. 13810 OF 2011)

J U D G M E N T

NAGARATHNA, J.

Since leave has been granted in Special Leave Petition Nos. 035895-035901 of 2011, in the connected matters also leave is granted.

2. In these cases, since common questions of law and facts arise, they have been clubbed together and are heard and disposed of by this common judgment. These appeals arise from the High Courts of Andhra Pradesh at Hyderabad pertaining to Secunderabad Club and the Madras High Court pertaining to Madras Gymkhana Club, Madras Cricket Club, The Coimbatore Cosmopolitan Club, Madras Club, M/s Wellington Gymkhana Club and M/s the Coonoor Club.

Bird's eye view of the controversy:

3. A short but interesting question of law arises in these cases, which is, whether the deposit of surplus funds by the appellant Clubs by way of bank deposits in various banks is liable to be taxed in the hands of the Clubs or, whether, the principle of mutuality would apply and the interest earned from the deposits would not be subject to tax under the provisions of the Income Tax Act, 1961 (hereinafter referred to as "the Act" for the sake of convenience). The High Courts in the impugned judgments have uniformly held that the interest earned on the bank

deposits made by the clubs is liable to be taxed in the hands of the clubs and that the principle of mutuality would not apply.

4. In the above context, the pertinent controversy is whether, the judgment of this Court in the case of ***Bangalore Club vs. Commissioner of Income Tax, (2013) 5 SCC 509 ("Bangalore Club")*** calls for reconsideration in view of the earlier order of this Court in ***Commissioner of Income Tax vs. M/s Cawnpore Club Ltd., Kanpur ("Cawnpore Club")*** disposed of by this Court on 05.02.1998 reported in ***(2004) 140 Taxman 378 (SC).***

5. While considering the above controversy, we dispose of these appeals by holding that the judgment in ***Bangalore Club*** does not call for reconsideration and these appeals could be disposed of in terms of the said judgment. We proceed to delineate on the subject and support our conclusion by first discussing the cases concerning ***Commissioner of Income Tax, Bihar vs. Bankipur Club Ltd., (1997) 5 SCC 394 ("Bankipur Club"); Cawnpore Club*** and ***Bangalore Club.***

Triology of cases:

a) Bankipur Club

In this case, twenty-three cases including seven appeals which were de-linked were classified into five groups which are as under:

(i) Group A concerned the question with regard to profits arising from the sales made to regular members of a club, being entitled to exemption on the doctrine of mutuality.

(ii) Group B was with regard to the question, whether, the income derived by a club from its house property let to its members and their guests was not chargeable to income tax and whether income derived by a club from the sale of liquor to its members and their guests was not taxable in its hands.

(iii) Group C cases pertained to the question, whether, chambers in the building of a club let out to members, annual value of a club house and pavilions and income earned from such properties owned by a club was liable to be taxed.

(iv) Group D cases were with regard to the question as to whether, an association consisting of film distributors and exhibitors incorporated as a company under Section 25 of the Companies Act, 1956 was liable to be taxed in respect of (a) admission fees, readmission fees, periodical subscriptions from the members etc., under the head “others” and (b) service charges from the members for rendering specific services to the members under the head “service to the members”, or the same would not be taxable on the principle of mutuality.

(v) Group E concerned cases where the assessee clubs had derived income from property let out and also interest received from

Fixed Deposit Receipt (FDR), National Savings Certificate (NSC), etc. by the clubs.

Paragraphs 4 and 19 of the ***Bankipur Club*** are relevant and they read as under:

> **4.** .... the appeals coming within Group E — ***CIT* v. *Cawnpore Club Ltd.*** (seven appeals) are de-linked and they will be posted separately to be heard on merits. We shall indicate the reason for this a little later.
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> **19.** The above four sets of cases falling in Groups A to D shall alone be covered by this judgment. With regard to 7 cases/appeals falling in Group E, the assessee is Cawnpore Club Ltd. It is seen that the income that was sought to be assessed in the case of the assessee, was one derived from property let out and also interest received from FDR, NSC etc. In these cases, the Court held that income should be assessed as one from "other sources" and not income from property. ***It does not appear that the larger plea that the income is totally exempt on the principle of mutuality, was decided in favour of the assessee***. In the appeals filed by the Revenue, the only question that may probably arise is, whether income received from the property let out and interest by way of FDRs, NSC etc. can be brought to tax under the head "income from property". Since the issue raised in this batch of seven cases is not similar to or same as the one involved in the other cases coming under Groups A to D, we do not propose to deal either with the facts or the decisions rendered by the authorities in this batch of cases (Group E). All that we propose to do is to de-link the cases coming under Group E and direct them to be posted separately for hearing and disposal before an appropriate Bench.

(emphasis by us)

b) Cawnpore Club:

Subsequent to de-linking of Group E cases in respect of ***Cawnpore Club,*** the order dated 05.02.1998 passed in those batch of appeals which formed Group E cases reads as under:

"IN THE SUPREME COURT OF INDIA

Civil Appeal Nos. 4777-78 of 1989,4534 of 1991,1773 of 1992,4303 of 1995, 3840 of 1996 and 8046 of 1995

5 February 1998

Decided On: 05.02.1998

Appellants: Commissioner of Income Tax

Vs.

Respondent: Cawnpore Club Ltd.

In the Supreme Court of India B.K Kirpal & S.P. Kurdukar, JJ.

ORDER

1. One of the questions which the High Court had decided in other cases relating to the same assessee was that the doctrine of mutuality applied and, therefore, the income earned by the assessee from the rooms let out to its members could not be subjected to tax. No appeal had been filed against the said decision and the matters stood concluded as far as the assessee was concerned. This being so, no useful purpose would be served in proceeding with the appeals on the other questions when the respondent cannot be taxed because of the principle of mutuality.

2. The appeals were accordingly dismissed. No order as to costs."

(emphasis by us)

The aforesaid order was passed by a two-Judge Bench of this Court on 05.02.1998.

c) Bangalore Club:

Thereafter, the decision in the case of ***Bangalore Club*** was rendered by another two Judge Bench on 14.01.2013.

In ***Bangalore Club***, the question was, whether, for the relevant assessment years, the said Club rightly sought an exemption from payment of income tax on the interest earned on the fixed deposits kept with certain banks, which were corporate members of the said club, on the basis of doctrine of mutuality. However, tax was paid on the interest earned on fixed deposits kept with non-member banks. In the said case, surplus amounts of the said Club were deposited in four banks which were members of the said Club. The question that arose was, whether, the principle of mutuality would apply to the funds deposited in the said four banks. Having regard to the fact that the said funds were raised from contribution of several members including the four banks which were corporate members of the said Club and the interest derived from it was utilised by several members of the assessee Club, in the said case, the High Court nevertheless held that the principle of "no man can trade with himself" would not be available in respect of a nationalised banks holding a fixed deposit on behalf of its customer. That the relationship is one of a banker and a customer. Consequently, the High Court reversed the decision of the Tribunal and restored the order of the assessing officer. Hence, an appeal was filed by the assessee ***Bangalore Club*** before this Court.

The question for determination before this Court was, whether, or not interest earned by the assessee on the surplus funds invested in fixed deposits with the corporate member banks is exempt from levy of income tax, based on the doctrine of mutuality. After appreciating the general understanding of the doctrine of mutuality in the context of the provision of the Act and by referring to ***New York Life Insurance Co. vs. Styles (Surveyor of Taxes), (1886-90) All ER Rep Ext 1362 ("Styles")*** and other judgments of the House of Lords and the High Court of Australia and by referring to the Simon's Taxes Vol. B. 3rd Edn., Paras B1.218 and B1.222 (pp.159 and 167) it was observed as under:

> **"18.** In short, there has to be a complete identity between the class of participators and class of contributors; the particular label or form by which the mutual association is known is of no consequence. Kanga and Palkhivala explain this concept in *The Law and Practice of Income Tax* (8th Edn., Vol. I, 1990) at p. 113 as follows:
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> > "**1.*Complete identity between contributors and participators***.-'*... The contributors to the common fund and the participators in the surplus must be an identical body. That does not mean that each member should contribute to the common fund or that each member should participate in the surplus or get back from the surplus precisely what he has paid.*' The Madras, Andhra Pradesh and Kerala High Courts have held that the test of mutuality does not require that the contributors to the common fund should willy-nilly distribute the surplus amongst themselves: it is enough if they have a right of disposal over the surplus, and in exercise of that right they may agree that on winding up the surplus will be transferred to a similar association or used for some charitable objects."
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> (emphasis supplied)
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22. The second feature demands that the actions of the participators and contributors must be in furtherance of the mandate of the association. In the case of a club, it would be necessary to show that steps are taken in furtherance of activities that benefit the club, and in turn its members. Therefore, in ***Chelmsford Club***, since the appellant provided recreational facilities exclusively to its members and their guests on "no-profit-no-loss" basis and surplus, if any, was used solely for maintenance and development of the Club, the Court allowed the exception of mutuality.

23. The mandate of the club is a question of fact and can be determined from the memorandum or articles of association, rules of membership, rules of the organisation, etc. However, the mandate must not be construed myopically. While in some situations, the benefits may be evident directly in the short run, in others, they may be accruable to an organisation indirectly, in the long run. Space must be made for both such forms of interactions between the organisation and its members. Therefore, as Finlay, J. observed in ***National Assn. of Local Govt. Officers* v. *Watkins (Inspector of Taxes)*,** where member of a club orders dinner and consumes it, there is no sale to him. At the same time, as in ***CIT* v. *Bankipur Club Ltd.*,** where a club makes "surplus receipts" from the subscriptions and charges for the various conveniences paid by members, even though there is no direct benefit of the receipts to the customers, the fact that they will eventually be used in furtherance of the services of the club must be considered as a furtherance of the mandate of the club.

24. Thirdly, there must be no scope of profiteering by the contributors from a fund made by them which could only be expended or returned to themselves. The locus classicus pronouncement comes from Rowlatt, J.'s observations in ***Thomas (Inspector of Taxes)* v. *Richard Evans & Co. Ltd.*** wherein, while interpreting ***Styles case***, he held that if profits are distributed to shareholders as shareholders, the principle of mutuality is not satisfied. He observed thus: (***Richard Evans case***, KB pp. 46-47)

> "… 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 is 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 *Styles 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 *Styles case* ."
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> (emphasis supplied)

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28. This brings us to the facts of the present case. As aforesaid, the assessee is an AoP. The banks concerned are all corporate members of the Club. The interest earned from fixed deposits kept with non-member banks was offered for taxation and the tax due was paid. Therefore, we are required to examine the case of the assessee, in relation to the interest earned on fixed deposits with the member banks, on the touchstone of the three cumulative conditions, enumerated above.

29. Firstly, the arrangement lacks a complete identity between the contributors and participators. Till the stage of generation of surplus funds, the set-up 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, the 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.

30. 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 categorised 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.

31. 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. The banks generate revenue by paying a lower rate of interest to assessee Club, 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 the banks to the outsiders for commercial reasons, in our opinion, snaps the link of mutuality and thus, breaches the third condition.

32. 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*** and ***Kumbakonam Mutual Benefit Fund Ltd.*** cases."

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34. 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.

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37. 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 of 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 set-ups 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***, when it said: (SCC p. 22, para 22)

> "*22. … 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 case***, TC p. 132 : KB at pp. 44 and 45.)"
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> (emphasis supplied)

38. 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 aforenoted 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.

Canara Bank:

Before proceeding to consider the submissions advanced at the Bar, it would be useful to discuss ***Canara Bank Golden Jubilee Staff Welfare Fund vs. Deputy Commissioner of Income Tax, (2009) 308 ITR 202 (Kar), ("Canara Bank")*** as learned senior counsel, Sri Datar, has relied upon the said judgment of the Division Bench of the High Court of Karnataka authored by one of us, Nagarathna J. In the said case, it was held that interest on investment and dividend on shares is governed by the principle of mutuality and therefore, not taxable, by relying on the decisions in ***Natraj Finance Corporation, (1988) 169 ITR 732*** and ***Chelmsford Club (2000) 243 ITR 89*** and by distinguishing the decision in ***I.T.I. Employees Death and Superannuation Relief Fund, (1998) 234 ITR 308 (Kar).*** The aforesaid conclusion was based on the source of fund of the assessee during the two relevant years. It was further observed therein that the

source of fund was wholly contributed by the members of the assessee during the relevant assessment years and therefore, the income on the aforesaid two heads was held to be not taxable. The Special Leave Petition filed against the said judgment was dismissed by this Court by order dated 28.07.2009.

However, two other High Courts namely, the Bombay High Court and the Madras High Court expressed reservations with respect to the observations in ***Canara Bank***. Speaking through Dr. D.Y. Chandrachud J. (as the learned Chief Justice then was), the Bombay High Court observed in ***Commissioner of Income Tax vs. Common Effluent Treatment Plant, (Thane-Belapur) Association, (2010) 328 ITR 362*** that the judgment in ***Canara Bank*** had struck a divergent note and therefore, the said judgment must be confined to the special facts as they occur in that case. The Karnataka High Court, while dealing with the issue in ***Canara Bank*** placed a great deal of emphasis on the source of funds of the assessee. The Karnataka High Court clarified that it was making it clear that its conclusion *"is based on the source of funds of the assessee during the two relevant years".* It was pointed out that the mere fact that the funds which were invested in fixed deposits with the banks were funds which originated from the contributions made by the members of the assessee cannot conclude the question as regards the taxability of the receipts on account of interest obtained from the investment of these funds. According to the

Bombay High Court these receipts must partake the character of income from other sources and would be exigible to tax.

In ***Madras Gymkhana Club Vs. Deputy Commissioner of Income Tax (2010) 328 ITR 348 (MAD)*** a Division Bench of the Madras High Court observed that whatever was stated in ***Canara Bank*** will have to be construed in the special facts and circumstances of that case and it cannot have universal application. It was further observed that investment of surplus fund with some of the member banks and other institutions in the form of fixed deposits and security which in turn result in earning interest cannot be held to satisfy the mutuality concept.

Submissions:

6. In the above backdrop of decisions of this Court as well as High Courts on the point of controversy, we shall now consider the rival submissions.

Submissions of Appellants:

6.1 The central theme of the submissions advanced by Sri Arvind Datar, learned senior counsel appearing for some of the appellant Clubs is that the two judge Bench Judgement of this Court in ***Bangalore club*** is not a binding precedent and therefore the same calls for reconsideration. In this regard, our attention was drawn to the order of another two-Judge Bench of this Court in the case of ***Cawnpore Club***

to contend that the judgment in ***Bangalore Club*** does not notice the order passed in ***Cawnpore Club***, the latter being in favour of appellant – assessees herein, and therefore, the judgment in ***Bangalore Club*** calls for reconsideration. In this regard, the judgment of the Karnataka High Court in ***Canara Bank*** was referred to and relied upon to contend that the principle of mutuality would apply even to interest earned from fixed deposits, National Savings Certificates etc. invested by the appellant-Clubs in various banks who may or may not be corporate members of these Clubs.

6.2 Elaborating on the said contentions, Sri Datar, submitted that income by way of receipts by several clubs for supply of food and beverages, admission fees, making available sporting and other facilities, or by way of renting rooms, halls etc. are exempted from payment of income tax on the basis of the principle of mutuality. That in ***Bankipur Club***, this Court had divided the cases into five groups (referred to above) and Group 'E' cases, which pertained to income earned from renting of rooms and interest earned from Fixed Deposits, National Savings Certificates etc. were de-linked. There were seven cases in Group "E' which were not decided in ***Bankipur Club***, but in the remaining cases, this Court upheld the principle of mutuality as being applicable to the income earned by the Club and held such income to be exempt from payment of income tax. In this regard, it was highlighted that the services offered by a social club to its members are

not with any profit motive and therefore, were not tainted with commerciality. Sri Datar submitted that subsequent to the delinking of the group "E" cases, this Court in ***Cawnpore Club*** held that the Revenue had not appealed with regard to the earnings from renting of rooms and that the other questions which arose in those appeals also included the question of interest earned on Fixed Deposit etc. invested in banks and it was held that such interest was also not taxable on the principle of mutuality. Therefore, the investment of surplus income made by the Clubs in the form of Fixed Deposits, Post Office Deposits etc. were exempt from payment of income tax on the basis of the mutuality principle.

6.3 It was next submitted that there is a direct conflict between the view taken in the case of ***Cawnpore Club*** and the judgment of this Court in ***Bangalore Club*** which are both two Judge Bench decisions. That from the year 2004 onwards till 2013, when the judgment in ***Bangalore Club*** was rendered by this Court, all interest earned from Fixed Deposits, Post Office Deposits, by the clubs, was entitled to exemption from payment of income tax since it was the surplus income of the clubs which was earned without any profit motive which was invested in the Banks and Post Offices and the interest income earned thereon was used exclusively for the benefit of the clubs and its members. However, the judgment in ***Bangalore Club*** reversed the entire prevalent view and denied exemption which was earlier available

to the clubs. Thereafter, various High Courts have followed the judgment of this Court in ***Bangalore Club*** and have disregarded the earlier order passed by this Court in ***Cawnpore Club***, which is not proper.

6.4 Learned senior counsel Sri Datar contended that there are glaring flaws in the reasoning of this Court in ***Bangalore Club*** and hence, the said judgment also being contrary to the order passed in ***Cawnpore Club***, is not a binding precedent and is *per incurium*. Therefore, the judgment in ***Bangalore Club*** ought to be reconsidered and the matter may be referred to a larger Bench.

6.5 In this context, Sri Datar submitted that the decision in the ***Bangalore Club*** fails to note that when there is no profit motive in the activities of a club and despite the fact that surplus income is generated, its activities and income cannot be tainted with commerciality. That in the said decision it was observed that the interest earned from fixed deposits made in Banks, Post Offices etc. were held to be commercial in nature as the Banks have used them for commercial operations by lending the said amounts to third parties and earning a higher interest. Therefore, the essential ingredients for the application of the principle of mutuality being ruptured, exemption was not available to the banks, *vis-à-vis*, the interest income earned from the fixed deposits was the reasoning, which is contrary to the order passed in the case of ***Cawnpore Club***.

6.6 In this context, it was further sought to be contended that when the triple test for the applicability of the principle of mutuality is satisfied, the notion of rupture of mutuality or one to one identity could not have been the basis for denying the exemption from payment of income tax on the interest income generated by the clubs. In this context, our attention was drawn to another two-judge bench judgment of this Court in ***State of West Bengal vs. Calcutta Club Ltd., (2019) 19 SCC 107*** wherein this Court observed that the principle of mutuality would apply to transactions covered within the scope of Article 366 (29-A) (e) of the Constitution (that is on sale of food and beverages and services rendered to the members of the club).

6.7 While placing heavy reliance on the order passed by this Court in the case of ***Cawnpore Club*** which has not been noticed in the subsequent judgment in ***Bangalore Club,*** it was contended by Sri Datar that the order in ***Cawnpore Club*** attracts the doctrine of merger inasmuch as the judgment of the Allahabad High Court had merged with the order of this Court and consequently, the order of this Court became a binding precedent under Article 141 of the Constitution. Therefore, for not referring to the said precedent, the judgment in ***Bangalore Club*** is liable to be reconsidered. In this context, reliance was placed on decision of this Court in the case of ***Kunhayammed vs. State of Kerala, (2000) 6 SCC 359 ("Kunhayammed")*** to contend that when a special leave petition is converted into a Civil Appeal, and

a judgment is rendered in the Civil Appeal, the same is a binding precedent to be followed subsequently by all courts unless this Court finds that the said decision requires reconsideration, in which event, the matter will have to be referred to a larger Bench. The same not having been done, there are now two decisions which have taken diametrically opposite views, namely, in the case of ***Cawnpore Club*** and in the case of ***Bangalore Club*** and hence, this batch of cases may be referred to a larger Bench for laying down the correct law on the point.

6.8 It was also submitted that the ITAT, Hyderabad Bench, in ***Fateh Maidan Club vs. Assistant Commissioner of Income Tax*** in ITA Nos.937, 939, 947and 952/Hyd/1995 and 716 to 720/Hyd/2000, Asst. yrs. 1983-84 to 1997-98 dated 13.08.2023, has categorically noticed that this Court had affirmed the judgment of the High Court in ***Cawnpore Club*** and had held in favour of assessee on all issues including the issue as to whether interest income earned by the clubs from fixed deposits made in the banks, post offices etc. would be exempt from tax on the basis of the principle of mutuality. Therefore, there was a consistency in the understanding of the order passed by this Court in ***Cawnpore Club*** and the same has now been diluted by the subsequent judgment of this Court in ***Bangalore Club***. Therefore, the matter requires reconsideration and it is necessary to revisit and consider the correctness of the judgment of this Court in ***Bangalore Club*** and hence, these appeals could be referred to a larger Bench.

6.9 Sri Andhyarjuna, learned senior counsel at the outset referred to Sub-Section 24 of Section 2 of the Act which defines Income Tax and particularly clause (vii) which speaks about the profits and gains of any business of insurance carried on by a mutual insurance company or by a co-operative society, computed in accordance with Section 44 or any surplus taken to be profits and gains by virtue of provisions contained in the First Schedule of the Act. That there is an express inclusion under the said provision income earned by any business of insurance carried on by a mutual insurance company or by a cooperative society but all other entities such as social clubs do not come within the scope of the said provision. The reason being that such entities do not earn any profits as such so as to be included within the definition of income. In this regard, reference was also made to Section 56 of the Act which speaks about income from other sources. The said provision states that income of every kind which is not to be excluded from the total income under the Act is chargeable to income tax under the head, "Income from other sources" if it is not chargeable to income tax under any of the heads specified under items (a) to (e) of Section 14. Such income from other sources is in the nature of a revenue receipt. In so far as social clubs and mutual associations are concerned the character and nature of the receipt is immaterial. What is important is utilisation of the income earned by a club, which is only for the benefit of its members. Therefore, interest earned on fixed deposits made by the clubs being a

source of income, it would not matter as to whether it is a capital or a revenue receipt.

6.10 It was next submitted that although the principle of mutuality is not defined under the Act, the judicial precedent has been that income from interest earned on fixed deposits is not taxable. But the judgment of this Court in ***Bangalore Club*** has not taken into consideration the definition of income, the facts as to utilisation of such income for the benefit of its members of a club and the nuances of the principle of mutuality. Therefore, the said judgment is not correct and is contrary to the previous of judgment of this Court in ***Cawnpore Club***.

6.11 It was next contended that although the decision in ***Cawnpore Club*** is termed as an "Order" it is nevertheless a reaffirmation of the judgment of the High Court, and therefore, the said "Order" would be a precedent for subsequent cases. But in ***Bangalore Club***, a coordinate Bench of this Court has not considered the Order passed in ***Cawnpore Club*** and hence, there are now two judgments which are diametrically opposite on the question of the application of the principle of mutuality to interest income earned by clubs. In this regard, our attention was also drawn to a judgment of the Telengana High Court in ***Jubilee Hills International Centre vs. Income Tax Officer*** reported in ***2023 SCC OnLine TS 41***, wherein it was observed that the Tribunal was not justified in taking a view that the principle of mutuality would not apply with reference to transactions entered into by the appellant therein with

regard to non-permanent or non-life members. Learned senior counsel therefore, also contended that the judgment of this Court in ***Bangalore Club*** requires reconsideration.

6.12 Learned senior counsel Sri Andhyarujina with reference to the facts in the case of Secunderabad Club submitted that it is an association of persons which is a mutual association and the Club is a social or recreational Club existing solely for the benefit of its members. The main object of the Club is for promoting social activities including sports and recreation amongst its members and various services can be availed by its members. That the surplus income generated by the Club consists of payments made by the members for use of the Club. The surplus income of the Club is deposited in banks by way of fixed deposits, post offices, national savings certificates etc., which are the only modes in which the surplus income could be deposited having regard to the provisions of the Act. Therefore, the said deposits being surplus income generated by the Club from the members, through the activities of the Club, the interest earned on the said deposits is also exempt from payment of income tax on the principle of mutuality. It was submitted that irrespective of whether the banks are corporate members of the club or not, there is complete identity between the source of deposits made by the Club in banks, post offices etc. and the beneficiaries of the interest earned, as the interest earned on the said deposits are being used for the benefit of the members of the Club. It

was further submitted that the members of the Club, as a class, contribute towards earning the surplus income and if the same is deposited in a bank, which is a corporate member and interest is earned which is ultimately used for the benefit of the members, the said transaction would attract the principle of mutuality.

6.13 In this regard, it was pointed out that it was not right to reason that when fixed deposits are made in banks by the clubs such as Secunderabad club and such funds are utilised by the banks for their lending and other business, there would be a rupture or diversion in the application of the principle of mutuality. It was highlighted that when the surplus income of the clubs is deposited in fixed deposit and interest earned on the said deposits is ultimately accounted for in the kitty of the clubs to be utilised for the benefit of the members of the clubs, there is no diversion of funds by the clubs to any member or to non-members. Just like any prudent individual who would invest surplus income in fixed deposits until the said amounts are needed for use, in the same way the clubs, instead of keeping the surplus income idle, are depositing the same in fixed deposits and when interest is generated on the said deposits, the same would ultimately flow towards the use and expenditure for the benefit of the members of the clubs. Therefore, there is complete identity which is one of the essentials for application of the principle of mutuality and the same has been explained in the case of ***Calcutta Club*** with reference to the judgment

in the case of ***Bangalore Club***. That the three-judge Bench in ***Calcutta Club*** has categorically observed that the principle of mutuality is applicable to incorporated or unincorporated clubs even after the 46th Amendment to Article 366 (29-A) of the Constitution of India and therefore, by the said reasoning of the three-Judge Bench, the judgment in ***Bangalore club*** would call for reconsideration.

6.14 Sri Kapur, learned senior counsel only highlighted with regard to the income earned from fixed deposits made by the clubs in member banks only. That in ***Bangalore Club***, this Court had failed to distinguish between the two kinds of transactions, namely, one between the club and the banks and the other, between the banks and its borrowers which are totally disjunct and therefore, the reasoning in the judgment of this Court in ***Bangalore Club*** would call for a reconsideration. Our attention was also drawn to the judgment of this Court in ***CIT vs. Venkatesh Premises Coop. Society Ltd., (2018) 15 SCC 37,*** particularly, paragraph 19 thereof.

Submissions of respondents:

6.15 Sri Balbir Singh, learned senior counsel and Additional Solicitor General appearing for the respondent - Revenue at the outset submitted that the judgments impugned in these appeals would not call for any interference as they have proceeded on a correct analysis of the nature of transaction involved when the clubs invest their surplus income in

Banks, Post Offices, or other similar deposits so as to earn interest thereon. It was contended that the judgment of this Court in ***Bangalore Club*** squarely covers the facts and issues involved in these cases and the said judgment does not call for reconsideration. In this regard, it was submitted at the outset that the three-Judge Bench decision in the case of ***Calcutta Club*** does not cover the issues involved in the present case and therefore, the same has to be distinguished.

6.16 While dealing with the facts and the reasoning of this Court in ***Bangalore Club***, it was contended by the learned ASG that as regards the generation of surplus funds, the principle of mutuality would apply but as soon as the funds are invested in the form of fixed deposits in the banks (whether corporate members of the club or not), in post offices or through national savings certificates etc., the funds suffer a deflection as a result of being exposed to commercial banking operations or operations of the post offices, which utilise the said funds deposited by the said clubs for advancing loans to their customers and thus, generating a higher income by lending it a higher rate to the third party customers and paying a lower rate of interest on the fixed deposits made by the clubs. That this activity of the banks of utilising the funds of the clubs which are in the form of fixed deposits towards its banking activities with third parties who are outside the net of mutuality, is purely a commercial operation. Therefore, there is a rupture of the principle of mutuality, resulting in a breach of one of the conditions of

the principle of mutuality, namely, identity between contributors and participators. That the surplus funds are not used directly by the clubs towards any specific service, maintenance or any other direct benefit for the members of the club, but are deposited in the form of fixed deposits in banks to be at the disposal of the said banks for its operations vis-*a*-*vis* third parties, namely, customers of the banks. Therefore, there is no identity *vis-a-vis* the third parties being the customers of the banks and the members of the Clubs. Hence, the principle of mutuality would not apply. According to the learned ASG, this is so irrespective of whether the fixed deposits are made in banks which are corporate members of the clubs or in any other bank or post offices. That the interest accrued on the fixed deposits made by the clubs is similar in nature to any other banks' deposit earning an interest made by any other customer of the bank during the course of banking operations and hence, it has a taint of commerciality which is fatal to the principle of mutuality.

6.17 It was next contended that for the application of principle of mutuality, there has to be a no-profit motive in the activities of the club, exclusively for the benefit of the members of the Clubs. Therefore, there cannot be avoidance of the liability to pay tax on such income earned by the clubs on the principle of mutuality. It was emphasised by the learned ASG that the relationship between the club with a bank as a customer of the banks is a business relationship just as any other customer of the bank would have a relationship with a bank and hence,

the protection of mutuality cannot be invoked to such transactions which are purely commercial in nature. In this regard, our attention was drawn to various paragraphs of the judgment of this Court in the case of ***Bangalore Club*** to contend that the reasoning therein is just and proper which would not call for reconsideration by a reference to a larger Bench.

6.18 Learned ASG also drew our attention to the fact that the Bombay High Court as well as the Madras High Court had not concurred with the judgment of the Karnataka High Court in ***Canara Bank*** and they observed that the said judgment may be restricted to the facts of that case alone and cannot act as a precedent particularly in view of the judgment of this Court in ***Bangalore Club***. It was sought to be contended that the judgment in ***Bangalore Club***, had impliedly overruled the decision of the Karnataka High Court in ***Canara Bank***.

Learned ASG submitted that these appeals lack merit and therefore, the same may be dismissed.

Reply Arguments:

6.19 By way of reply, learned senior counsel, Sri Datar, while briefly reiterating his submissions drew our attention to the fact that the special leave petition filed against the judgment of the Karnataka High Court in ***Canara Bank*** was dismissed and therefore, this Court having affirmed the said judgment of the High Court, which is in line with the judgment of this Court in ***Cawnpore Club***, the subsequent judgment in

Bangalore Club taking a totally contrary view as held by this Court earlier, requires reconsideration. Therefore, the observations of the Bombay High Court as well as the Madras High Court on ***Canara Bank*** are not binding and are in the nature of *obiter*.

6.20 It was submitted that till the judgment of this Court in ***Bangalore Club*** was delivered, all the social clubs could claim exemption from payment of income tax on the interest income earned on the fixed deposits in banks, post offices etc., however, since 2013, the interest income is subject to tax which may be 30% or above which will greatly affect the exchequer of the clubs and reduce the surplus income at the hands of the club which would be prejudicial to the very existence of the social clubs which ultimately are non-profit entities. Learned senior counsel Sri Datar therefore, urged that there may be a reference to a larger Bench, for reconsideration of the decision in ***Bangalore Club***, so as to benefit the assessee clubs.

6.21 It was also reiterated that the Order in ***Cawnpore Club*** is a declaration of law and the same ought to have been considered by a Coordinate Bench of this Court in ***Bangalore Club***. That the decision in ***Cawnpore Club*** is a fall out of the judgment in ***Bankipur Club*** and the same is of binding nature. While referring to the judgment of this Court in the case of ***Kunhayammed***, Sri Datar submitted that the decision in ***Cawnpore Club*** attracts the doctrine of merger and the said judgment would also be binding.

6.22 It was reiterated that the aspect of profit motive cannot be attributed to clubs as the only intention behind depositing surplus funds of the clubs in a bank is a matter of prudence and the interest earned thereon along with the principal amount deposited would only be used for the benefit of the members of a club. Therefore, he urged that at the outset, this Bench may consider as to whether the judgment in ***Bangalore Club*** would call for reconsideration, while closing his arguments.

Points for Consideration:

7. Having heard learned senior counsel and counsel for the respective parties, we find that the following points would arise for our consideration:

a) Whether the judgment of this Court in ***Bangalore Club*** would call for reconsideration in light of the "Order" of this Court in ***Cawnpore Club***?

b) Whether the interest on income earned by Clubs such as the appellants herein would be covered under the principle of mutuality and therefore be exempt from payment of tax?

c) What Order?

Principle of mutuality:

8. At the outset it would be useful to understand and discuss the principle of mutuality in the context of income tax law.

8.1 The principle of mutuality is rooted in common sense. A person cannot make a profit from herself. This implies that a person cannot earn profit from an association that he shares a common identity with. The essence of the principle lies in the commonality of the contributors and the participants who are also beneficiaries. There has to be a complete identity between the contributors and the participants. Therefore, it follows, that any surplus in the common fund shall not constitute income but will only be an increase in the common fund meant to meet sudden eventualities.

8.2 The landmark House of Lords precedent on the application of the doctrine of mutuality to the taxability of the surplus made by mutual benefit associations is the ***Styles*** *case***.** The members of New York Life Insurance Company comprised its policyholders. The Company calculated insurance premium based on the estimated death rate in its membership. The surplus of premium collected after deducting the expenditure incurred towards insurance claims was returned to the members in the form of credit to their account. The question was whether the surplus returned to the members – being earned from and by holders of the participating policies - was liable to be assessed to income tax as profits or gains. The insurance company sought to

distinguish its case from ***Last vs. London Assurance Corporation, 10 App. Cas. 438 ("London Assurance Corporation"),*** wherein surplus premiums credited to members of the insurance company were held to be exigible to tax. The Company argued that its premium income was not profit, and hence not amenable to income tax. The Queen's Bench Division being of the opinion that the case could not be distinguished from ***London Assurance Corporation***, held that the premium income of the Company received under participating policies was liable to be assessed to income tax and reversed the determination of the Commissioners. This decision was affirmed by the Court of Appeal.

8.3 Against these decisions, the company brought an appeal before the House of Lords. The House of Lords was divided in the ratio 4:2 in the matter, with the majority holding that that no part of the premium income received under participating policies was liable to be assessed to income tax as profits or gains. That ***London Assurance Corporation*** was distinguishable, the income in that case being derived from transactions with persons who were not members and not from mutual insurances between members only.

8.4 The majority concluded that for income to be taxable, its source must be external to the Assessee. The fact that the Fund is a legal entity (for certain purposes) does not matter for, in the language of Lord Watson, it represented "the aggregate of its members and the members are the participators of its profits." Lord Halsbury and Lord Fitzgerald

dissented. Lord Halsbury reasoned that the nature of business would be more relevant than the relationship between the parties. Lord Fitzgerald, in his dissenting opinion, concluded that the premiums earned by the insurance company, so transferred to its headquarters in New York, 'for the purpose of investment there by the corporation, formed part of the profit of the concern, and became liable here to income tax.' He adjudicated the dispute independently, without placing any reliance on ***London Assurance Corporation,*** which was sought to be distinguished by the Assessee. While acknowledging the difference between the facts of both cases, to the extent that policyholders were members of the New York Life Insurance Company, but outsiders as regards ***London Assurance Corporation,*** it was concluded that 'distinction creates no real difference.'

Evolution of the principle of mutuality in India:

8.5 The Calcutta High Court also made a notable contribution to the evolution of the common law on mutuality. In ***Royal Calcutta Turf Club vs. Secretary of State, (1921) ILR 48 Cal 844 : AIR (1921) Cal 633 : (1921) 1 ITC 108***, the Calcutta High Court considered the case of an unincorporated club that carried on business within the meaning of the Excess Profits Duty Act (10 of 1919). The Calcutta High Court reasoned that the proceeds generated by way of entrance fees charged from the public and the license fees credited by the book makers, would be assessable to income tax.

8.6 The Privy Council's decision in an appeal emerging from the Madras High Court, in ***English and Scottish Joint Co-Operative Wholesale Society, Ltd. vs. Commissioner of Agricultural Income-Tax, 1948 SCC OnLine PC 41,*** crystallized the triple test for applying the principle of mutuality:

(1) the identity of the contributors with and recipients of the common fund;

(2) the status of the association or company, as an instrument obedient to the mandate of its members; and

(3) the absence of possibility for contributors of the fund to derive profits from contributions made by them.

8.7 Substantial emphasis was placed on the pricing of the services offered and the profit motive behind the same. It was noted that the English and Scottish Joint Co-operative Wholesale Society, Ltd. is not bound by its rules to sell its tea only to its members, but it could make no difference if it were. The pertinent observations in this regard, are extracted as under:

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

Given the deep-rooted common law tradition, Indian jurisprudence has had a rich engagement with the principle of mutuality, especially in the context of taxation.

8.8 A Constitution Bench of this Court in ***CIT vs. Royal Western India Turf Club Ltd., AIR 1954 SC 85*** rendered a significant judgment on this subject. Royal Western India Turf Club realised money from both members and non-members, in lieu of the same services rendered in the course of the same business. The Supreme Court held, as extracted below, that an exemption founded on the doctrine of mutuality could not be granted:

> "*23.* As already stated, in the instant case there is no mutual dealing between the members 'inter se' and no putting up of a common fund for discharging the common obligations to each other undertaken by the contributors for their mutual benefit. On the contrary, we have here an incorporated company authorised to carry on an ordinary business of a race course company and that of licensed victuallers and refreshment purveyors and in fact carrying on such a business. *There is no dispute that the dealings of the company with non-members take place in the ordinary course of business carried on with a view to earning profits as in any other commercial concern.*"

This Court further reasoned that the principles of ***Styles*** *case* had no application to the case before it. This Court noted that 'there is no mutual dealing between the members inter se in the nature of mutual insurance, no contribution to a common fund put up for payment of liabilities undertaken by each contributor to the other contributors and no refund of surplus to the contributors.

8.9 At this stage, it would be apposite to consider some English and American cases on the aspect of mutuality.

8.9.1 In ***Walter Fletcher on his own behalf and on behalf of Trustees and Committee of Doctor's Cave Bathing Club vs. the Commissioner of Income Tax ("Walter Fletcher")*** reported in ***(1971) UKPC 30***, the Privy Council considered the question whether, the Doctor's Cave Bathing Club at Montego Bay, Jamaica (appellant therein) was assessable to income tax on the profit element contained in receipts from certain hotels, whose guests had the right to use the said Club. It was observed therein that the expression "the mutuality principle" has been devised to express the basis for exemption of groups of persons making contribution towards the common purpose or any surplus over expenditure. That it is a convenient expression, but the situations it covers are not in all respects alike. In some cases, the essence of the matter is that the group of persons in question is not in any sense trading, so the starting point for an assessment for income tax in respect of trading profits does not exist. In other cases, there may be in some sense a trading activity, but the objective or the outcome, is not profits, it is merely to cover expenditure and to return any surplus, directly or indirectly, sooner or later, to the members of the group. These two criteria often, perhaps generally, overlap since one of the criteria of a trade is the intention to make profits and a surplus comes to be called a profit if it derives from a trade. So, the issue is better framed as one question, rather than two: is the activity, on the one hand, a trade, or an adventure in the nature of trade, producing a profit, or is it on the other, a mutual arrangement which, at most, gives rise to a surplus.

8.9.2 On the facts of the said case, it was observed that the disparity between the member of the club and the guest of the hotel (hotel members) was substantial. In other words, the members of the club were trading, earning profits from the hotel which used to send their guests for using the club facilities, commensurate with their subscription. Therefore, any surplus income derived by the said Club from the hotel members was in the nature of profits and therefore the nature of the transaction being a trading transaction, the income thus generated was liable for tax.

8.9.3 Reference was made to the case of ***The Carlisle & Silloth Golf Club vs. Smith, (1912) 6 TC 48***, which brings out the distinction between members, contributing on a mutual basis in order to secure an amenity, and outsiders admitted to participate in amenities on payment, with whom the club is trading. At what point, does the relationship of mutuality end and that of trading begin? That is the critical and difficult question and the relevance of facts is to ascertain the nature of the activity. It was observed that it is not an essential condition of mutuality that contributions to the fund and rights in it should be equal; but if mutuality is to have any meaning, there must be a reasonable relationship, contemplated or in result, between what a member contributes and what with due allowance for interim benefits of enjoyment, he may expect or be entitled to draw from the fund i.e., there ought to be a relationship between his liabilities and his rights.

8.9.4 In ***Revesby Credit Union Cooperative Ltd. vs. Federal Commissioner of Taxation, (1965) 112 CLR 564***, the High Court of Australia considered the question, whether, principle of mutuality applies to deprive the dividend of the character of income. It was observed that the principle of mutuality seems to be settled in cases where a number of people contribute to a fund created and controlled by them for a common purpose. In such cases, any surplus paid to the contributors after the use of the fund for the common purpose is not income but is to be regarded as a mere repayment of the contributor's own money *vide* ***Bohemians Club vs. Acting Federal Commissioner of Taxation, (1918) 24 CLR 334***. Incorporation of the fund is not relevant *vide* ***Styles***. What is required is that the fund must have been created for the common purpose and owned or controlled wholly by the contributors. If it is owned or controlled by anyone else the principle cannot apply *vide* ***Equitable Life Assurance Society of the United States vs. Bishop, (1900) 1 QB 177.*** Furthermore, any contributions to the fund derived from sources other than the contributors' payments, such as interest from the investment of part of the fund, or income from a business activity conducted by the members, cannot be taken into account in computing the surplus *vide* ***Carlisle and Silloth Golf Club vs. Smith*** (supra). Also, the cases establish that the principle cannot apply unless at any given point in time the contributors to the fund are identical with the beneficiaries of the distribution of the surplus *vide* ***Styles*** (supra).

8.9.5 While applying the aforesaid dicta to the facts of the said case, it was held that the principle of mutuality cannot apply to deprive the dividend of the character of income. The dividend in question therein was the surplus of revenue over expenditure. The greater part of the revenue was drawn from two sources namely, interest on loans to members and interest on investments in associated credit societies. The contributors to the revenue are those members who had current loans and the societies in which money was invested. However, the beneficiaries of the payment of the dividend were all the members. It was observed that the revenue earned was by virtue of the society's business dealings with a number of its members and should be classed as income.

8.9.6 In ***Re: Commissioner of Taxation And: Australian Music Traders Association, (1990) FCA 261***, the case pertained to the Australian Music Traders Association, a mutual association. The controversy was whether such a mutual association or organization which received income from an activity would fall within the mutuality principle. In the said case, reference was made to ***Walter Fletcher*** (supra) and the test enunciated therein by Lord Wilberforce with regard to the nature of an activity undertaken by a mutual association or a club namely, whether, the activity is a trade or an adventure in the nature of trade, producing a profit, or is it, a mutual arrangement which, wholly gives rise to a surplus. In the said case, the activity in

question was the holding of a music traders' trade fair. In the years prior to the subject year of income, the Association itself had organised the trade fairs and let out stalls to music traders. Although the rental income received by the Association from such stall holders who were members of the Association was accepted to be mutual, nevertheless, as the individual traders displayed and sold their wares to members of the public, it was doubted whether the fairs had a mutual character. Traders, many of whom were not members of the Association, carried on their individual businesses. The rental paid was calculated according to the space occupied or leased by the stall holder for the purposes of his own business activity. In the year of income in question, the Association had arranged for a separate organisation, namely, Exhibition and Trade Fair Pvt. Ltd., to organise the fair. The fee which the Association received from the organiser was fixed by their agreement, though referrable in part to the total space sublet by the organiser to members of the Association and non-members alike. It was observed that no strand of mutuality remained as no contribution was made by any member of the Association to the Association in respect of the fair. That the amount paid by the organiser of the fair to the Association was not a fee payable by the members of the Association into a common fund and the fair, though it benefitted members of the Association, was not a mutual, non-profit activity. Its essence was that of trading for profit by individual traders, though through the medium of a common activity, the fair. Therefore, it was observed that the

Association's receipts from the organiser of the fair were not receipts which had a mutual character. The receipts were income assessable to tax.

8.9.7 Discussing the early formulations of the mutuality principle which was generally associated with insurance, reference was also made to ***Styles*** (supra) which was followed in ***Jones vs. South-West Lancashire Coal Owners' Association Limited, (1927) AC 827 (Jones).*** Five years later, in ***Municipal Mutual Insurance Limited vs. Hills, (1932) 16 TC 430***, the House of Lords distinguished ***Styles*** and ***Jones***. The facts in the latter case were that the appellant therein was formed by various local authorities primarily for the purpose of enabling them to insure against fire, on favourable terms. The effective control of the said Company was held by fire policy holders, who alone were entitled to the surplus assets of the Company on winding up of the Company. However, in the course of time, the Company also undertook an extensive business in employers' liability and other insurances, both with existing fire policy holders and others. The revenue conceded that the fire insurance business is a business of mutual insurance which did not attract liability to income tax. The appellant company therein agreed that it was liable for tax on its profits from employers' liability and other insurances undertaken on behalf of persons who were not fire policy holders. However, there was an issue between the parties as to whether the appellant company was liable to pay tax on the profits

which it earned on such other insurances, with fire policy holders. At first instance, Justice Rowlatt dealt with the critical question and analysed that in the said case there was no distinction between what is made out of a member in respect of non-fire business and what is made out of a stranger in respect of non-fire business; the member is a stranger. He is not, as a miscellaneous policy holder, getting any share in the miscellaneous policy business. The miscellaneous policy business is done for the benefit of the body of fire policy holders. Therefore, revenue earned out of fire insurance business of the company by the members who were all fire policy holders was a business of mutual insurance which did not attract liability to income tax but the revenue earned from miscellaneous policy business was taxable. The position was compared to a shareholder of a railway company who buys a ticket to travel by train; for this purpose, he is merely an outsider.

8.9.8 The aforesaid analysis of Rowlatt J. was affirmed by the Court of Appeal as well as by the House of Lords. The House of Lords clarified that insofar as surplus income arising from a fire policy, they are really entitled to the money as being those who contributed it and, accordingly, it has been admitted that any profit made on the fire policies is governed by the ***Styles*** case (supra). But as regards employers' liability business and miscellaneous business the surplus it did not go to the contributors for, as fire policy holders in a body, they

had not contributed and therefore this business was in the same position as business with complete outsiders, the surpluses in which are admitted to be profit.

8.9.9 Reference was also made to another Australian decision in the case of ***Social Credit Savings and Loans Society Limited vs. Commissioner of Taxation, (1971) 125 CLR 560,*** wherein the necessity for identicality between the contributors to the common fund and the participators in it, was emphasised.

8.9.10 Reference was also made to ***Sydney Water Board Employees' Credit Union Limited vs. Commissioner of Taxation, (1973) 129 CLR 446*** which is a decision of the Full High Court of Australia. In the said case, the facts are interesting. The taxpayer was a credit union which borrowed money from its members. It also borrowed money, to a smaller amount, from non-members, on fixed deposit. The money borrowed was re-lent by it to members, but the class of borrowing members was not identical with the class of lending members; some borrowing members did not lend money to the taxpayer, and some lending members did not borrow. The taxpayer received interest on the money lent by it, and obtained surpluses over its expenditure. The issue was whether the interest received by the credit union from its members was taxable under the Australian Income Tax Act. The Court unanimously held that the interest was taxable.

8.9.11 While considering the application of the mutuality principle in the said case, it was held that there were two impediments: that precise identicality between the individuals contributing to a fund and the participants in that fund was no longer required. However, there ought be a "reasonable relationship" between contributions and benefits and that no such relationship existed, as all members of the Association had not taken space at the 1984 Australian Music Exhibition. Secondly, it was observed that the money received by the Association in respect of the exhibition was not the money held on behalf of individual members. The money became part of the general funds of the Association, to be dealt with as the members of the Association might see fit from time to time, but without any obligation to those members who had taken space at the 1984 exhibition. Till 1984, the Association used to organise the fair itself using voluntary members' labour but in 1985, the fair was organised by a professional organiser i.e., through the Company (Exhibition and Trade Fairs Pty Limited). There were forty-eight exhibitors out of which only twenty-nine were members of the Association. The claim was initially rejected by the Commissioner of Income Tax on the basis that the receipt must be treated as an ordinary trading receipt received in the course of the Association's business. It was held that the principle of mutuality did not apply. Ultimately, the High Court of Australia by a majority of 2:1 held that the Commissioner was right and affirmed his decision and set aside the decision of the Tribunal.

Analysis:

9. While considering the questions that arise in these appeals, we have to take into account the following aspects:

a) Whether the Order of this Court in ***Cawnpore Club*** is a binding precedent which ought to have been taken note of and considered by a Co-ordinate Bench of this Court while deciding the case of ***Bangalore Club?***

b) Whether the judgment of the Karnataka High Court in ***Canara Bank*** has to be restricted to the facts of the said case although the special leave petition filed against the said judgment was dismissed by this Court?

c) Whether a Coordinate Bench of this Court has rightly decided the case of ***Bangalore Club***?

10. Learned senior counsel, Sri Datar, placed heavy reliance on the judgment of this Court in ***Kunhayammed vs. State of Kerala, AIR (2000) SC 2587***, to contend that once an appeal has been preferred or a petition seeking leave to appeal has been converted into an appeal before the Supreme Court, that is, once leave has been granted in a Special Leave Petition, the appellate jurisdiction of the Supreme Court is invoked and the judgment or order passed in appeal would attract the doctrine of merger. The order may be of reversal, modification or merely of affirmation. That in the case of ***Cawnpore Club,*** the order of

this Court clearly attracts the doctrine of merger inasmuch as this Court gave its imprimatur to the judgment of the Allahabad High Court impugned in those civil appeals by categorically stating that the doctrine of mutuality would apply in the context of the interest earned on fixed deposits made in a bank by Cawnpore Club. If that be so, then the law declared by the Supreme Court in the case of ***Cawnpore Club*** would be a binding precedent and ignoring the said judgment in a subsequent case, a Coordinate Bench of this Court had passed a contradictory judgment, i.e., in the case ***Bangalore Club.*** Therefore, it was contended that the judgment of this Court in ***Bangalore Club*** being *per incuriam,* cannot have any precedential value and if this Bench is to accept the said position, then the earlier order passed by this Court in ***Cawnpore Club*** must be applied in the instant case, or in the alternative, the matter could be referred to a larger Bench for considering the correctness or otherwise of the judgment in ***Bangalore Club***.

11. While considering the said submission, it is noted that in ***Bankipur Club***, in so far as the Group A and D cases were concerned, it was held that the principle of mutuality applied and therefore, income earned from such activities was exempt from taxation. As already noted above in ***Bankipur Club,*** Group "E" cases in which the assessee clubs earned income from interest received from fixed deposits receipts (FDR) and National Savings certificates (NSC etc.) were de-linked, to be posted

separately to be heard on merits. In paragraph 19 of the judgment in ***Bankipur Club***, the reasons for segregation or delinking of the cases falling under Group "E" has been specifically stated, the reason being that in those appeals, the question was with regard to income earned from letting out property only. Thereafter in ***Cawnpore Club***, another Coordinate Bench noted that the High Court had decided that "*the income earned from the assessee from the rooms let out to its members could not be subjected to tax*". No appeal had been filed against the said decision by the Revenue on that point and therefore, the matter stood concluded in so far as the assessee therein, namely, Cawnpore Club was concerned. Having said that, it was further observed that no useful purpose would be served in proceeding with the appeals on the other questions when the respondent cannot be taxed by virtue of the principle of mutuality. This Court did not spell out what "the other questions" were in respect of which the respondent Cawnpore Club could not be taxed owing to the principle of mutuality. It must be remembered that the appeal had been filed by the Revenue against Cawnpore Club and not *vice-versa*. In the absence of there being even an indication as to "the other questions" in respect of which, this Court found that the proceedings in the appeals filed by the Revenue could not be continued because of the principle of mutuality, such an observation would not imply that the order passed in the said case is a binding precedent within the scope and meaning of Article 141 of the Constitution. It must be remembered that the appeals in the case of

Cawnpore Club were filed by the Revenue and merely because the Revenue did not press its appeal in respect of the other aspects of the case and this Court found that the income earned by the assessee from the rooms let out to its members could not be subjected to tax on the principle of mutuality, it would not mean that the other questions which were not pressed by the Revenue in the said appeal stood answered in favour of the asseesse and against the Revenue. On the other hand, in the absence of there being any indication in the order as to what "the other questions" were in respect of which the principle of mutuality applied, in our view, there is no *ratio decidendi* emanating from the said order which would be a binding precedent for subsequent cases. In view of the disposal of Revenue's appeals in the case of ***Cawnpore Club*** by a brief order *sans* any reasoning and *dehors* any ratio, cannot be considered to be a binding precedent which has been ignored by another Coordinate Bench of this Court while deciding ***Bangalore Club.*** In our view, the Order passed in ***Cawnpore Club*** binds only the parties in those appeals and cannot be understood as a precedent for subsequent cases.

12. In this regard, it would be useful to refer to the judgment of the Division Bench of the Patna High Court in ***Patna Golf Club vs. CIT, 2016 SCC OnLine Patna 2067 (Misc. Appeal No. 541 of 2007)*** wherein after referring to ***Bankipur Club*** and the order passed subsequently in ***Cawnpore Club,*** it was observed that on a reading of the order of this Court in ***Cawnpore Club,*** no inference could be drawn

to the effect that the principle of mutuality would apply to interest income earned on fixed deposits made in the banks. It was further observed that interest earned on income cannot be part of income from house property and consequently, it is income from other sources. Reference was also made to ***Sports Club of Gujarat Ltd. vs. CIT, 171 ITR 504*** to observe that when income is derived from investments in fixed deposits in Banks, it is derived from a third party and is not by way of contributions of the members of the club and therefore, such interest earned on income is taxable and the principle of mutuality would not apply.

Ratio decidendi:

13. It is a settled position of law that only the *ratio decidendi* of a judgment is binding as a precedent. In ***B. Shama Rao vs. Union Territory of Pondicherry, AIR 1967 SC 1480***, it has been observed that a decision is binding not because of its conclusion but with regard to its ratio and the principle laid down therein. In this context, reference could also be made to ***Quinn vs. Leathem, 1901 AC 495 (HL),*** wherein it was observed that every judgment must be read as applicable to the particular facts proved, or assumed to be proved, since the generality of the expressions which may be found there are not intended to be expositions of the whole law, but governed and qualified by the particular facts of the case in which such expressions are found. In other words, a case is only an authority for what it actually decides.

14. Reliance could also be placed on the dissenting judgment of A.P. Sen, J. in ***Dalbir Singh vs. State of Punjab, (1979) 3 SCC 745***, wherein his Lordship observed that a decision on a question of sentence depending upon the facts and circumstances of a particular case, can never be regarded as a binding precedent, much less "law declared" within the meaning of Article 141 of the Constitution so as to bind all courts within the territory of India. According to the well-settled theory of precedents, every decision contains three basic ingredients:

(i) findings of material facts, direct and inferential. An inferential finding of fact is the inference which the Judge draws from the direct or perceptible facts;

(ii) statements of the principles of law applicable to the legal problems disclosed by the facts; and

(iii) judgment based on the combined effect of (i) and (ii) above.

For the purposes of the parties themselves and their privies, ingredient (iii) is the material element in the decision, for, it determines finally their rights and liabilities in relation to the subject-matter of the action. It is the judgment that estops the parties from reopening the dispute. However, for the purpose of the doctrine of precedent, ingredient (ii) is the vital element in the decision. This is the *ratio decidendi*. It is not everything said by a judge when giving a judgment that constitutes a precedent. The only thing in a judge's decision binding a party is the principle upon which the case is decided and for

this reason it is important to analyse a decision and isolate from it the *ratio decidendi*.

15. In the leading case of ***Qualcast (Wolverhampton) Ltd. vs. Haynes, 1959 AC 743,*** it was laid down that the *ratio decidendi* may be defined as a statement of law applied to the legal problems raised by the facts as found, upon which the decision is based. The other two elements in the decision are not precedents. A judgment is not binding (except directly on the parties to the *lis* themselves), nor are the findings of fact. This means that even where the direct facts of an earlier case appear to be identical to those of the case before the court, the judge is not bound to draw the same inference as drawn in the earlier case.

16. The legal principles guiding the decision in a case is the basis for a binding precedent for a subsequent case, apart from being a decision which binds the parties to the case. Thus, the principle underlying the decision would be binding as a precedent for a subsequent case. Therefore, while applying a decision to a later case, the court dealing with it has to carefully ascertain the principle laid down in the previous decision. A decision in a case takes its flavour from the facts of the case and the question of law involved and decided. However, a decision which is not express and is neither founded on any reason nor proceeds on a consideration of the issue cannot be deemed to be law declared, so as to have a binding effect as is contemplated under Article 141, *vide* ***State of Uttar Pradesh vs. Synthetics and Chemicals Ltd. (1991) 4 SCC***

139. Article 141 of the Constitution states that the law declared by the Supreme Court shall be binding on all the courts within the territory of India. All courts in India, therefore, are bound to follow the decisions of Supreme Court. This principle is an aspect of judicial discipline.

17. If a decision is on the basis of reasons stated in the decision or judgment, only the *ratio decidendi* is binding. The ratio or the basis of reasons and principles underlying a decision is distinct from the ultimate relief granted or manner of disposal adopted in a given case. It is the *ratio decidendi* which forms a precedent and not the final order in the judgment, *vide* ***Sanjay Singh vs. Uttar Pradesh Public Service Commission, Allahabad; (2007) 3 SCC 720***. Therefore, the decision applicable only to the facts of the case cannot be treated as a binding precedent.

18. The doctrine of binding precedent helps in promoting certainty and consistency in judicial decisions and enables an organic development of the law besides providing assurance to individuals as to the consequences of transactions forming part of daily affairs. Thus, what is binding in terms of Article 141 of the Constitution is the ratio of the judgment and as already noted, the *ratio decidendi* of a judgment is the reason assigned in support of the conclusion. The reasoning of a judgment can be discerned only upon reading of a judgment in its entirety and the same has to be culled out thereafter. The ratio of the case has to be deduced from the facts involved in the case and the particular provision(s) of law which the court has applied or interpreted

and the decision has to be read in the context of the particular statutory provisions involved in the matter. Thus, an order made merely to dispose of the case cannot have the value or effect of a binding precedent.

19. What is binding, therefore, is the principle underlying a decision which must be discerned in the context of the question(s) involved in that case from which the decision takes its colour. In a subsequent case, a decision cannot be relied upon in support of a proposition that it did not decide. Therefore, the context or the question, while considering which, a judgment has been rendered assumes significance.

20. As against the *ratio decidendi* of a judgment, an *obiter dictum* is an observation by a court on a legal question which may not be necessary for the decision pronounced by the court. However, the *obiter dictum* of the Supreme Court is binding under Article 141 to the extent of the observations on points raised and decided by the Court in a case. Although the *obiter dictum* of the Supreme Court is binding on all courts, it has only persuasive authority as far as the Supreme Court itself is concerned.

21. In the context of understanding a judgment, it is well settled that the words used in a judgment are not to be interpreted as those of a statute. This is because the words used in a judgment should be rendered and understood contextually and are not intended to be taken literally. Further, a decision is not an authority for what can be read into it by implication or by assigning an assumed intention of the judges

and inferring from it a proposition of law which the judges have not specifically or expressly laid down in the pronouncement. In other words, the decision is an authority for what is specifically decides and not what can logically be deduced therefrom.

22. Further, the precedential value of an order of the Supreme Court which is not preceded by a detailed judgment would be lacking inasmuch as an issue would not have been categorically dealt with. What is of essence in a decision is its ratio and not every observation found therein, nor what logically follows from the various observations made therein.

23. Another important principle to be borne in mind is that declaration of the law by the Supreme Court can be said to have been made only when it is contained in a speaking order, either expressly or by necessary implication and not by dismissal *in limine*. In the words of Mukherji, CJ, in ***DTC vs. DTC Mazdoor Congress Union, AIR 1991 SC 101,*** the expression 'declared' is wider than the words 'found or made'. The latter expression involves the process, while the former expresses the result.

24. In view of the aforesaid discussion, we think that we cannot accept the argument advanced by learned Sr. Counsel, Sri Datar, for the following reasons: firstly, the Order in ***Cawnpore Club*** is not on the basis of any reasoning or a deduction made as to whether on the interest earned on fixed deposits made by a club in a bank, income tax would be attracted or not. In the absence of any deduction or reasoning

or analysis, the said order cannot carry precedential value so as to be binding on this Court in a subsequent case. This is because there is no discernable *ratio decidendi* in the said Order. Of course, the said Order would bind the parties to the case. While carefully reading the Order passed by this Court in ***Cawnpore Club,*** it can be discerned that the High Court had clearly spelt out that in the case of income earned from letting out of rooms/property to its members, the same would not be subjected to tax. On the aforesaid aspect, the revenue had not filed any appeal before this Court, and therefore, on that aspect the matter should conclude in favour of the assessee therein i.e. Cawnpore Club. Secondly, without going into the other aspects of the case, this Court simply noted that the assessee therein (***Cawnpore Club***) could not be taxed on the principle of mutuality, therefore, it would not serve any purpose to proceed with the appeals on the other questions. What those other questions were has not been spelt out in the order nor have reasons been assigned as to on what aspect or activities of the said Club and its transactions the principle of mutuality would apply. In the absence of there being any clear indication in the discussion or analysis and there being a simple closure of a case, it would clearly imply that the doctrine of mutuality would apply only to those activities to which it would normally apply. That is different from saying that even in the case of income earned by a club from non-members or income earned from investment made by a club in fixed deposits in a bank would attract the principle of mutuality and therefore, no tax is payable.

Thirdly, if an order of this Court is brief and meant only for the purpose of closure of the controversy involved in a particular case and with a view to conclude the case, undoubtedly, such an order is binding on the parties to the said order, but in our view, it cannot act as a precedent for subsequent cases such as the present one with which we are dealing.

25. In fact, in paragraph 19 of ***Bankipur Club,*** while considering the interest income received on fixed deposits, this Court observed that such income could be considered as income from other sources and not income from property. It was further observed by this Court, "*It does not appear that the larger plea that the income is totally exempt on the principle of mutuality, was decided in favour of the assessee*.". It was in the above context that the Group "E" cases were segregated as this Court was of the view that the income earned from the property let out and also interest received on the fixed deposits could be considered separately.

26. When the appeals were considered thereafter in the case of ***Cawnpore Club*** this Court simply applied the principle of mutuality to the income earned by the club from rooms rented out to its members as not being subject to tax. As far as the other questions were concerned, this Court only observed that *"no useful purpose would be served in proceeding with the appeals on the other questions when the respondent cannot be taxed because of the principle of mutuality."* This observation

in ***Cawnpore Club*** must be juxtaposed with the observations expressed above in ***Bankipur Club***. When the aforesaid observations made in ***Cawnpore Club*** are considered in light of the larger plea, we find that the same was not answered in ***Bankipur Club*** nor in ***Cawnpore Club.*** But, the subsequent decision in ***Bangalore Club*** ultimately answered the said larger plea through a detailed reasoning. Therefore, it cannot be held that the short order passed in ***Cawnpore Club*** is a precedent which was ignored by a Coordinate Bench of two judges in ***Bangalore Club***, so as to make the latter decision *per incuriam.* On the other hand, we are of the view that the larger plea which was neither considered in ***Bankipur Club*** nor in ***Cawnpore Club*** was ultimately considered and answered in ***Bangalore Club*** by a detailed judgment.

27. Therefore, we do not find any fault in a subsequent Coordinate Bench of this Court in ***Bangalore Club*** in not noticing the Order passed in the case of ***Cawnpore Club*** while dealing, in a detailed manner, on the taxability of the income earned from the interest on fixed deposits made by the said Club in banks, whether the banks are members of the clubs or not. Thus, not much can be read into the Order dated 05.02.1988 passed in the case of ***Cawnpore Club*** so as to hold that the same was law declared by this Court within the meaning of Article 141 of the Constitution and hence, is a binding precedent which ought to have been followed by a subsequent Coordinate Bench of this Court in ***Bangalore Club*** and the same not having been done, renders the judgment in ***Bangalore Club*** vulnerable or vitiated. In the

circumstances, we do not find it necessary and justified to refer the judgment of this Court in ***Bangalore Club*** to a Larger Bench on this ground. Further, we also think that the order dated 05.02.1998 passed by this Court in the Civil Appeals concerning ***Cawnpore Club*** is not a binding precedent which had to be followed in subsequent cases, as the said Order did not declare any law.

28. As far as the judgment of the Karnataka High Court in ***Canara Bank*** is concerned, although the Special Leave Petition challenging the same was dismissed by this Court, we find merit in the observations of the Bombay High Court and the Madras High Court to the effect that the said judgment must be restricted to its own facts and the same cannot be considered as a precedent. In this regard, what is of significance to note is that the judgment of Karnataka High Court in ***Bangalore Club*** was not brought to the notice of the Division Bench of the said Court which decided ***Canara Bank***. Had the Division Bench known about the judgment passed by a Coordinate Bench of that Court in ***Bangalore Club*** holding that interest earned on fixed deposits in banks is liable to be taxed and that the principle of mutuality would not apply, possibly, the judgment in ***Canara Bank*** may have been different. Therefore, we hold that the judgment in ***Canara Bank*** is restricted to the facts of that case and cannot be construed to be a precedent as such.

29. It would be useful to refer to certain other judgments of this Court having relevance to the points under consideration.

(a) In a three-Judge Bench decision in ***State of West Bengal vs. Calcutta Club Ltd., (2019) 19 SCC 107***, this Court considered the following questions:

> 30.1. (i) Whether the doctrine of mutuality is still applicable to incorporated clubs or any club after the 46th Amendment to Article 366(29-A) of the Constitution of India?
>
> 30.2. (ii) Whether the judgment of this Court in Young Men's Indian Assn. still holds the field even after the 46th Amendment of the Constitution of India; and whether the decisions in Cosmopolitan Club and Fateh Maidan Club which remitted the matter applying the doctrine of mutuality after the constitutional amendment can be treated to be stating the correct principle of law?
>
> 30.3. (iii) Whether the 46th Amendment to the Constitution, by deeming fiction provides that provision of food and beverages by the incorporated clubs to its permanent members constitute sale thereby holding the same to be liable to sales tax?"

The aforesaid questions arose in the context of Article 366(29-A) which is a provision inserted to the Constitution of India by virtue of the 46th Amendment to the Constitution and in the context of the West Bengal Sales Tax Act, regarding tax on sale or purchase of goods.

This Court referred to the judgment in the case of ***Bangalore Club*** and observed that the doctrine of mutuality as applied to clubs envisages a complete identity between contributors and participators. Referring to *Halsbury's Laws of England, 4th Edn., Reissue, Vol.23, Paras 224* it was observed that members' clubs are an example of mutual undertaking; ***but, where a club extends facilities to non-members, to that extent, the element of mutuality is wanting.***

That a members' club is assessable in respect of profits derived from affording its facilities to non-members. That where non-members are offered facilities on the payment of fees, then, the club was carrying on a business which could be isolated and the profit from which was assessable to income tax. But there is no liability in respect of profits made from members who avail themselves of the facilities provided for members. In short, there has to be a complete identity between the class of participators and the class of contributors of funds; the particular label or form by which the mutual association is formed is of no consequence.

It was further observed that if persons carry on a certain activity in such a way that there is a commonality between contributors of funds and participators in the activity, a complete identity between the two is then established. Since the members perform the activities of the club for themselves, the fact that they incorporate a legal entity to do it for them makes no difference. Reference was also made to Section 2(24)(vii) of the Act which defines taxable income. The doctrine of mutuality, based on common law principles, is premised on the theory that a person cannot make a profit for himself. Therefore, amount received from oneself cannot be regarded as income and be held to be taxable. It was observed that income of a cooperative society from business is taxable under Section 2(24)(vii) and will stand excluded from the principle of mutuality. It was concluded that the doctrine of mutuality

continues to be applicable to incorporated and unincorporated members' clubs even after the 46th Amendment introducing Article 366(29-A) into the Constitution of India and that sub-clause (f) of the said Article has no application to member's clubs in the context of the Finance Act, 1994 which, *inter alia,* deals with tax on services.

After discussing elaborately on the definition of club or association; taxable service in the context of payment of service tax; and in the context of the definition of 'service' under the Finance Act, 1994, it was observed that from 2005 onwards, the Finance Act, 1994 does not purport to levy service tax on members' clubs in the incorporated form. That the judgment in ***Young Men's Indian Assn.*** made no distinction between a club in the corporate form and a club by way of a registered society or incorporated by a deed of trust.

(b) In ***Yum! Restaurants (Marketing) Pvt. Ltd. vs. Commissioner of Income Tax, Delhi, (2021) 7 SCC 678***, this Court speaking through Khanwilkar, J. in paragraph 17 observed as under:

> "17. In order to undertake the examination of mutuality, we gainfully advert to English & Scottish Joint Coop. Wholesale Society Ltd. v. CAT, which has been quoted with approval by this Court in CIT v. Royal Western India Turf Club Ltd. and Bangalore Club. The aforestated stream of judicial pronouncements expound three conditions/tests to prove the existence of mutuality:
>
> (i) Identity of the contributors to the fund and the recipients from the fund;
>
> (ii) Treatment of the company, though incorporated as a mere entity for the convenience of the members

> and policy-holders, in other words, as an instrument obedient to their mandate, and;
>
> (iii) Impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves.
>
> Whereas the legal position on what amounts to a mutual concern stands fairly settled, the factual determination of the same on a case-to-case basis poses a complex issue that requires deeper examination. Such examination ought to be conducted in the light of the tests enunciated above."

While discussing the element which involves the test of commonality of identity between the members or participators in the mutual concern and the beneficiaries thereof, and applying the three-pronged test extracted hereinabove, it was observed that common identity signifies that the class of members should stay intact as the transaction progresses from the stage of contributions to that of returns/surplus. Therefore, there must be uniformity in the class of participants in the transaction. It was further observed that "the moment such a transaction opens itself to *non-members*, either in the contribution or the surplus, the uniformity of identity is impaired and the transaction assumes the tint of a commercial transaction. The emphasis on the words *member* and *non-member* is of import because the doctrine of mutuality does not prohibit the inclusion or exclusion of new members. It was observed, what is prohibited is the infusion of a participant in the transaction who does not become a "member" of the common fund, at par with other members, and yet participates either

in the contribution or surplus without subjecting himself/herself to mutual rights and obligations. The principle of common identity prohibits any one-dimensional alteration in the nature of participation in the mutual fund as the transaction fructifies. Any such alteration would lead to the non-uniform participation of an external element or entity in the transaction, thereby opening the scope for a manifest or latent profit-based dealing in the transaction, with parties outside the closed circuit of members. Such profit-oriented activity would be amenable to income tax as per Section 2(24) of the Act.

Moving further, this Court observed that coterminous with the requirement of common identity, is the requirement of completeness of identity between the contributors and participators which is contemplated under the doctrine. In order to determine whether there is completeness of identity or breach of mutuality, the court is well within its powers to go beyond the periphery of the concern and undertake an examination, akin to the lifting of the veil, in order to discern the real nature thereof. It was also observed that mutuality and non-profiteering character of a concern are to be determined in light of its actual working structure and the factum of corporation or incorporation or the form in which it is clothed is immaterial. In the said case, the questions were answered against the assessee company and in favour of the revenue.

30. We have considered the arguments advanced at the Bar on behalf of the respective parties; and considered the nuances of the principle of mutuality in the context of the applicability of the said principle with regard to the interest income earned on fixed deposits made in banks/financial institutions by the appellant Clubs, in the backdrop of the dictum of this Court in the case of ***Bangalore Club***.

31. While considering the triple test for applying the principle of mutuality, we find that in the case of ***Bangalore Club***, the aforesaid triple test was applied. It was reiterated that the principle of mutuality envisages:

(i) Complete identity between the contributors and participators;

(ii) Action of the participators and contributors must be in furtherance of the mandate of the associations or the Clubs. The mandate of the Club is a question of fact which has to be determined from the Memorandum or Articles of Associations, Rules of Membership, Rules of the Organisation, etc., which must be construed broadly.

(iii) There must be no scope for profiteering by the contributors from a fund made by them which could only be expended or returned to themselves.

32. Applying the aforesaid principles to the facts of the case, it was observed in ***Bangalore Club***, that in relation to transactions, namely, deposit of surplus funds earned by the clubs, in banks which are members of the club, the principle of mutuality applies till the stage of

deposit of funds and would lose its application, once the funds are deposited as fixed deposit in the banks. This is because the funds would be exposed to commercial banking operations which means that the deposits could be used for lending to third parties and earning a higher interest thereon and by paying a lower rate of interest on the fixed deposits to the clubs. That the bank's utilizing the funds of the clubs deposited in fixed deposit receipts, for their banking business would completely rupture the "privity of mutuality" and as a result, the element of complete identity between the contributors and participators would be lost. Consequently, the first condition for the claim of mutuality is not satisfied.

33. That, it is not a normal activity of the appellants-clubs to deposit funds in a bank. It is only when a surplus is generated. These appellant Clubs just like Bangalore Club are social clubs, and it is the surplus funds earned through various activities of the Clubs which are deposited as fixed deposit in the banks so as to earn an interest owing to the business of banking. In the absence of the said fixed deposits being utilized by the banks for their transactions with their customers, no interest can be payable on the fixed deposits. This is so in respect of any customer of a bank who would deposit surplus funds in a bank. It may be that the interest income would be ultimately used for the benefit of the members of the Clubs but that is not a consideration which would have an impact on satisfying the triple test of mutuality. It was observed in ***Bangalore Club*** that even if ultimately the interest income and

surplus funds in the fixed deposit are utilized for the benefit of the members of the clubs, the fact remains that when the fixed deposits were made by the clubs in the banks, they were exposed to transactions with third parties, i.e., between the banks and its customers and this would snap the principle of mutuality breaching the triple test. When the reasoning of this Court in ***Bangalore Club*** is considered in light of the judgments of overseas jurisdictions, it is noted that this proposition would squarely apply even to fixed deposits made in banks which are members of the clubs. In other words, it is only profit generated from the payments made by the members of the clubs, which would not be taxable. This was also the reasoning in the case of ***Royal Western India Club*** (supra), wherein it was observed that where services are rendered by the club to both members and non-members, the dealings of the Club with non-members is in the ordinary course of the business carried on with a view to earn the profits, as in any other commercial concern and hence, subjected to tax. This is on the principle that complete identity between the contributors and the recipients is absent.

34. The question asked therefore is - at what point does the relationship of mutuality end and that of trading begin. If there is an entry of a third party or non-member to deal with the contributions of or funds of the club or to utilize the funds of the club and return the same with interest, then, the relationship of the parties is not on the basis of a privity of mutuality. The essential condition of mutuality, i.e., identity between the contributors and participators would end. The

relationship would then be like any other commercial relationship such as that between a customer and a bank where the fixed deposit is made by the customer for the purpose of earning an interest income.

35. If the principle of mutuality is to apply, then, where a number of people contribute to a fund are ultimately paid the surplus from the fund, it is a mere repayment of the contributors' own money. However, if the very same surplus fund is not applied for the common purpose of the club or towards the benefit of the members of the club directly but is invested with a third party who has the right to utilize the said funds, subject to payment of interest on it and repayment of the principal when desired by the club, then, in such an event, the club loses its control over the said funds. Further, the interest generated on the fixed deposits or investment made is a commercial activity, thereby permitting the bank to utilize the fixed deposit amount for its banking business and derive profits from the said banking business by way of lending the amount for a higher rate of interest while paying a lower rate of interest on the fixed deposit made by the club. Thus, identicality between the contributors to the common fund and the participators in it which is a *sine qua non* for the application of the principle of mutuality would get ruptured. When surplus funds of a club are invested as fixed deposits in a bank and the bank has a right to utilize the said fixed deposit amounts for its banking business subject to repayment of the principal along with interest, then, the identity is lost.

36. Conversely, when the facilities of the club are offered to members as well as to non-members for a price, there is a vital distinction between the transactions, i.e., between the club and its members *vis-a-vis* club and non-members. When the facilities of a club are extended to the members of the club who contribute towards the income generated by the club, there is an identity between the contributors and the recipients and, therefore, the principle of mutuality would apply. However, if the same facilities of the club are offered to non-members or to the public for the purpose of earning an additional income, then, it is in the nature of a commercial transaction and thus becomes a profitable venture. In such a case, the principle of mutuality would not apply.

37. In order for the triple test to apply to the different and varied transactions of the clubs, it is necessary to lift the veil and discern the nature of each transaction: whether there is third party intervention which is the reason for earning the income; or it is an income generated between the members and the club, as such, i.e., only between the members of the club. When the transactions of the club are viewed in the aforesaid prism then, in each of the transactions whether the principle of mutuality would apply, has to be discerned.

38. The attractive argument advanced by Sri Datar and Sri Andhyarjuna regarding the utilisation of the interest income towards the benefit of the members of the club is repelled by a fundamental principle of income tax. The said principle is propounded by the House

of Lords in ***Mersey Docks vs. Lucas, 8 App. Cas. 891 ("Mersey Docks")***. In the said case it is held that the mode of application of the surplus generated out of a trading activity has no bearing on its taxability. To borrow from the conclusion in that case, the Revenue's *"right to be paid the tax out of it in the least degree depends on what they do with it afterwards."*

39. In the circumstances, we find that the reasoning given by the Coordinate Bench of this Court in ***Bangalore Club*** is just and proper and would not call for reconsideration.

40. The reasoning in ***Bangalore Club*** is also fortified by judgments from overseas jurisdictions, discussed above, such as ***Municipal Mutual Insurance Limited vs. Hills; Walter Fletcher; Re: Commissioner of Taxation And: Australian Music Traders Association.***

41. In the circumstance, we do not find that the judgment in ***Bangalore Club*** is not a binding precedent for the reason that it does not refer to the earlier judgment of this Court in ***Cawnpore Club***. Secondly, on a close reading of reasons assigned by this Court in ***Bangalore Club*** we find that they are justified and squarely apply to the cases at hand.

42. In this context, the sagacious dictum of seven learned Judges of this Court in ***Keshav Mills Co. Ltd. vs. CIT, (1965) 2 SCR 908*** ought to guide the exercise of jurisdiction on questions that have been duly

settled by judgments of this Court. In the said case, it was observed as follows:

> "**23**. … [I]n reviewing and revising its earlier decision, this Court should ask itself whether in the interests of the public good or for any other valid and compulsive reasons, it is necessary that the earlier decision should be revised. When this Court decides questions of law, its decisions are, under Article 141, binding on all courts within the territory of India, and so, it must be the constant endeavour and concern of this Court to introduce and maintain an element of certainty and continuity in the interpretation of law in the country. Frequent exercise by this Court of its power to review its earlier decisions on the ground that the view pressed before it later appears to the Court to be more reasonable, may incidentally tend to make law uncertain and introduce confusion which must be consistently avoided. That is not to say that if on a subsequent occasion, the Court is satisfied that its earlier decision was clearly erroneous, it should hesitate to correct the error; but before a previous decision is pronounced to be plainly erroneous, the Court must be satisfied with a fair amount of unanimity amongst its members that a revision of the said view is fully justified. It is not possible or desirable, and in any case it would be inexpedient to lay down any principles which should govern the approach of the Court in dealing with the question of reviewing and revising its earlier decisions. It would always depend upon several relevant considerations:— What is the nature of the infirmity or error on which a plea for a review and revision of the earlier view is based? On the earlier occasion, did some patent aspects of the question remain unnoticed, or was the attention of the Court not drawn to any relevant and material statutory provision, or was any previous decision of this Court bearing on the point not noticed? Is the Court hearing such plea fairly unanimous that there is such an error in the earlier view? What would be the impact of the error on the general administration of law or on public good? Has the earlier decision been followed on subsequent occasions either by this Court or by the High Courts? And, would the reversal of the earlier decision lead to public inconvenience, hardship or mischief? These and other relevant considerations must be carefully borne in mind whenever this Court is called upon to exercise its jurisdiction to review and revise its earlier decisions."

Conclusion:

43. In view of the above discussion, we arrive at the following conclusions:

(i) The Order of this Court in ***Cawnpore Club*** cannot be treated as a precedent within the meaning of Article 141 of the Constitution of India as the said order does not declare any law and the appeals filed by the revenue as against ***Cawnpore Club*** were disposed of without going into the larger question as to whether Cawnpore Club could be taxed on the interest income earned on fixed deposits made by it in the banks, or whether the principle of mutuality would apply to the said income.

(ii) The judgment of this Court in ***Bangalore Club*** does not call for reconsideration even when viewed in light of the previous Order of this Court in ***Cawnpore Club.*** Consequently, we hold that the principle of mutuality would not apply to interest income earned on fixed deposits made by the appellant Clubs in the banks irrespective whether the banks are corporate members of the club or not.

(iii) In view of the above, we hold that the judgment in ***Bangalore Club*** is not *per incuriam* although, the earlier Order passed by a Coordinate Bench of this Court in the case of ***Cawnpore Club*** is not noticed in ***Bangalore Club.***

(iv) We also hold that the judgment of the Division Bench of the Karnataka High Court in ***Canara Bank*** must be restricted to apply to the facts of the said case alone and cannot be a precedent for subsequent cases. This is because the judgment of another Division Bench of the said High Court in the case of ***Bangalore Club*** was not brought to the notice of the Division Bench, which rendered the judgment in the case of ***Canara Bank***. Further, it is the judgment of the Division Bench of the said High Court in ***Bangalore Club*** that has been sustained by a Coordinate Bench of this Court by a detailed reasoning.

(v) Thus, the interest income earned on fixed deposits made in the banks by the appellant Clubs has to be treated like any other income from other sources within the meaning of Section 2(24) of Income Tax Act, 1961.

(vi) Conversely, if any income is earned by the Clubs through its assets and resources, from persons who are not members of the Clubs, such income would also not be covered under the principle of mutuality and would be liable to be taxed under the provisions of the Income Tax Act.

(vii) In view of the above conclusions and having found that ***Bangalore Club*** does not call for reconsideration, we hold that the said judgment which holds the field would squarely apply to these appeals also.

Consequently, the appeals are dismissed.

Parties to bear their respective costs.

Pending applications, if any, stand disposed of.

.....J.
(B.V. NAGARATHNA)

.....J.
(PRASHANT KUMAR MISHRA)

NEW DELHI;
AUGUST 17th, 2023.