CIVIL REFERENCE

Before Falshaw and Kapur, JJ.

1953

May, 27th

THE HOSHIARPUR CENTRAL CO-OPERATIVE BANK, LTD.,—*Petitioner*

versus

THE COMMISSIONER, INCOME-TAX, SIMLA,—*Respondent.*

Civil Reference No. 3 of 1952.

Income-tax Act (XI of 1922), Section 10—Government of India Notification F.D.(C.R) Notification R. Dua No. 291-IT/25, dated 25th August, 1925, as subsequently amended on the 25th of June, 1927—Co-operative Bank dealing in sugar and standard cloth with special permission of the authorities— Income earned from such activities—Whether exempt from income-tax.

Held, that where income is derived by a co-operative society from the business of the society as a co-operative society, the profits are within the exemption given by the Government notification, but where profits arise out of some business even though it may be permitted, but not of the nature which follows out of the objects of the co-operative society, then in that case the exemption will not apply.

The Madras Central Urban Bank, Limited v. *The Commissioner of Income-tax* (1), *The Madras Provincial Co-operative Bank, Ltd., Madras* v. *The Commissioner of Income-tax, Madras* (2), In re *the Commissioner of Income-tax, Burma* v. *The Bengalee Urban Co-operative Credit Society, Limited* (3), *Carlisle and Silloth Golf Club* v. *Smith* (4), *Commissioner of Inland Revenue* v. *Sparkford Vale Co-operative Society, Limited* (5), *New York Life Insurance Company* v. *Styles* (6), relied on.

Case referred by the Income-tax Appellate Tribunal, Bombay, (DELHI BENCH) consisting of M/s. K. N. Raj Gopal Shastri, Judicial Member and A. L. Sehgal, Accountant Member with his R.A. Nos. 366 and 367 of 1951-52 dated 4th March, 1952 under section 66(1) of the Indian Income-tax Act, 1922 (Act XI of 1922) as amended by section 92 of the Income-tax (Amendment) Act, 1939

(1) I.L.R. 52 Mad. 640
(2) I.L.R. 56 Mad. 837
(3) I.L.R. 11 Rang. 521
(4) (1913) 3 K.B. 75
(5) 133 L.T. 231
(6) 14 A.C. 381

(Act VII of 1939) for the decision of the Hon'ble Judges of the High Court.

SHAMAIR CHAND and P. C. JAIN, for Petitioner.

S. M. SIKRI, *Advocate-General*, H. R. MAHAJAN and RAJINDER SACHAR, for Respondent.

JUDGMENT.

KAPUR, J. This is a reference made by the Income-tax Appellate Tribunal referring the following question to this Court— Kapur, J.

> " Where a co-operative bank deals in sugar and standard cloth with special permission of the authorities and earns income from such activities, is such income exempt from tax under Item No. 2 of the Government of India Notification F.D. (C.R.) Notification R. Dua. No. 291-I. T/25, dated 25th August, 1925, as subsequently amended (Income-tax Manual, 10th Edition, Part II, page 257-258) ? "

The assessee, the Hoshiarpur Central Co-operative Bank, Limited, Hoshiarpur, was registered under section 9 of the Co-operative Societies Act, and the objects as mentioned in the bye-laws are—

> " 1. The carrying on of banking and credit business ;
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> 2. The purchase and sale for common account of agricultural implements and produce ;
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> 3. The supervision and audit of registered co-operative societies ;
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> 4. The provision of education-assistance to members of such societies ;
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> 5. Other measures designed to improve the work and extend the usefulness of such societies. "

The Hoshiarpur Central Co-operative Bank, Ltd.
v.
The Commissioner, Income-tax, Simla

Kapur, J.

It appears that due to reasons which are not disclosed but can well be imagined the Government authorised the assessee to deal in sugar, oil and standard cloth. For the purpose of this business they had to take usual permits which any other dealer in the same class of work would have had to do. In the previous assessment years, which are not the subject-matter of reference now, some profits were made which were held by the Assistant Commissioner of Income-tax not to be liable to taxation under the Income-tax Act. In the assessment years 1948-49 and 1949-50 the assessee Bank earned a profit of Rs. 39,694-12-0 and Rs. 25,877, respectively. By its order, dated the 11th of April, 1951, the Tribunal found that these profits were earned by the assessee not as profits of business as a Co-operative Society but on account of dealings which were "out of its line of business (*viz.* co-operative banking)." They also found that as the dealings were not "in its avowed business, the income was from 'other sources' referred to in section 12 of the Income-tax Act." It is on these facts that a reference has been made to this Court to answer the question which is mentioned above.

Some dispute did arise before us as to whether the business out of which the disputed items had been earned as profits was sanctioned by the Government or not, but the form of the question indicates that it was accepted by the Income-tax Commissioner that this work was permitted by the Provincial Government within section 31 of the Co-operative Societies Act.

It is not disputed that these two sums are profits and but for the exemption given by a notification under section 60, dated the 25th of August, 1925, as amended on the 25th of June, 1927, they would have been liable to income-tax. This notification is as follows—

> "(a) The profits of any co-operative society other than the Sanikatta Salt Owners' Society in the Bombay Presidency for

the time being registered under the Co-operative Societies Act, 1912 (II of 1912), the Bombay Co-operative Societies Act, 1925 (Bombay Act VII of 1925) or the Madras Co-operative Societies Act, 1932 (Madras Act VI of 1932) or the dividends or other payments received by the members of any such society out of such profits.

Explanation—For this purpose the profits of a Co-operative Society shall not be deemed to include any income, profits or gains from (1) investments (a) securities of the nature referred to in section 8 of the Indian Income-tax Act, or (b) Property of the nature referred to in Section 9 of that Act,

(2) dividends, or

(3) the 'other sources' referred to in section 12 of the Indian Income-tax Act."

The question for determination, therefore, is what is the meaning of the word 'profits' of a Co-operative Society. For the assessee it was submitted that as the Government had permitted the carrying on of this business these two sums are profits of the assessee Co-operative Society. On the other hand, the submission on behalf of the Revenue was that the word "profits" indicates the profit derived from such business which can be truly called the business of the Co-operative Society. It is not necessary here to quote the various sections which are applicable. Section 6 of the Income-tax Act gives the heads of income which are chargeable to income-tax, sub-clause (iv) being 'profits and gains of business, profession or vocation'. Section 10 deals with business and profits—

"10(1) The tax shall be payable by an assessee under the head of 'profits and gains of business, profession or vocation' in respect of the profit or gains of

The Hoshiarpur Central Co-operative Bank, Ltd. v. The Commissioner, Income-tax, Simla

Kapur, J.

any business, profession or vocation carried on by him."

Profit under section 10 as applied to Co-operative Societies has been the subject-matter of decision in several cases. In *the Madras Central Urban Bank, Limited* v. *The Commissioner of Income-tax* (1), a Co-operative Society was by an order of Government required to keep 40 per centum of its total liability under call deposits in a liquid or fluid form and the Society invested it in Government securities which produced interest. It was held that in the absence of proof that such investments are obligatory on the Society or are a part of its usual business, the interest on the securities was not part of the profits of the business of the Society. At page 647 of the judgment it is observed—

> "The obligation on the Bank to keep 40 per cent. of its total liabilities in a fluid form is in consequence of an administrative order of Government and does not oblige them, although it may permit them, to invest the fund at all, and it seems to me that as they are to hold the fund in readiness to meet some particular liability which is specified, it cannot be said to be part of their business as a Bank to invest these liquid assets in the interval."

The same Court again had to decide this question of a Co-operative Society to which the exemption under section 60 applied in *The Madras Provincial Co-operative Bank, Ltd., Madras* v. *The Commissioner of Income-tax, Madras* (2), and it was held there that the exemption from income-tax given by the notification is to the profits made by a Co-operative Bank from its business as a Co-operative Bank. The interest derived by a Co-operative Bank from its money invested in Government securities cannot be regarded as part of

(1) I.L.R. 52 Mad. 640
(2) I.L.R. 56 Mad. 837

the profits of the business *qua* such Bank and therefore is not exempt from tax, and the mere fact that a bye-law of the Bank makes the purchase and sale of Government Promissory Notes one of its main objects does not alter the position. Beasley, C.J., held that when an assessee is under a section of the Income-tax Act assessable to income-tax, it is for him to show that he has been exempted, and Cornish, J., said at page 845—

> "The petitioner having failed to show that the investment was made for carrying out some purpose for which the Bank has been founded, the only ground, as it seems to me, on which the interest from the investment might be held to be profits from the business disappears."

and Bardswell, J., said—

> "I agree that the interest derived by a Co-operative Bank from its investments in Government securities is not to be regarded as part of the profits of its business *qua* such Bank. I would take it that the exemption is meant as an encouragement to the employing of as much capital as possible for the financing of Co-operative Societies and to extending the scope of co-operation. The investing of money in Government securities does not further the cause of co-operation but is only a means of keeping from lying idle funds that cannot immediately be used for such a purpose."

The Rangoon High Court in *In re the Commissioner of Income-tax, Burma* v. *The Bengalee Urban Co-operative Credit Society, Limited* (1), had to deal with a similar question under the unamended notification where the notification which is now there did not exist. It was there held that profits of a Co-operative Society that are exempted from income-tax under the notification of the

(1) I.L.R. 11 Rang. 521

The Hoshiarpur Central Co-operative Bank, Ltd. *v.* The Commissioner, Income-tax, Simla

Kapur, J.

Government of India, dated the 25th August 1925, are the profits accruing to the Society from carrying on the business of a mutual Co-operative Society, and it was also held that where *prima facie* such income is chargeable to income-tax, the onus lies on the assessee to show that it is 'profits' within the notification and so exempt from income-tax. In that case income had accrued to the Society from investment of securities from house property and from other sources. Sir Arthur Page, Chief Justice, said at page 527—

> "Now it appears to me that the intention of the Governor-General in Council was to exempt from income-tax under the notification the profits accruing to co-operative societies from carrying on the business of a mutual co-operative society upon the ground that 'a man cannot make a loss or profit out of himself' and in this way to encourage and foster co-operative societies which were brought into being as the result of a movement to improve the conditions under which cultivators of the land in India and Burma lived and worked."

Continuing the learned Chief Justice said at page 530—

> "On the other hand 'profits' in this connection are 'the surplus by which the receipts from the trade or business exceed the expenditure necessary for the purpose of earning those receipts.
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> * * *
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> In my opinion, the term 'profits' in the notification of 25th August, 1925 is used in this latter sense, and *prima facie,* therefore, neither interest from securities nor income derived from property are 'profits' within the meaning of that term as used in the notification."

I may now refer to some of the English cases which have some relevance to the facts of the present case. In *Carlisle and Silloth Golf Club* v. *Smith* (1), the appellants were ordinary members of a golf club. In addition to the members of the club, who were entitled on payment of an annual subcription to play on the links and to other privileges for the current year, a considerable number of visitors were permitted to use the club premises and to play on the links in accordance with a provision contained in the lease. The total annual expenditure incurred by the club in maintaining the links in proper condition for play exceeded the total amount of fees received from visitors. It was held that the appellants were carrying on an enterprise which was beyond the scope of the ordinary functions of the club and that any profits derived from the visitors' green fees were, therefore, taxable under Schedule D of the Income-tax Act, 1842. At page 82, Buckley, L. J., said—

> "The club is here putting into its pocket money received not from its members but from outsiders. A man cannot make a profit or a loss out of himself, and that was the ground of decision in *New York Life Insurance Co.* v. *Styles* (2)."

In *the Commissioner of Inland Revenue* v. *Sparkford Vale Co-operative Society, Limited* (3), a Co-operative Society registered under the Act, dealing in milk purchased milk exclusively from its own members but sold the same or the products thereof in the open market, and it was held that the profits arose by transactions of sale to outsiders and hence this surplus was a trading profit and hence was not profit arising from the trading with its own members.

(1) (1913) 3 K.B. 75
(2) 14 App. Cases 381
(3) 133 L.T. 231

The Hoshiarpur Central Co-operative Bank, Ltd. v. The Commissioner, Income-tax, Simla

Kapur, J.

Reference was made to *the New York Life Insurance Company* v. *Styles* (1). In that case the Life Insurance Company had no shareholders. The only members were the holders of participating policies. A calculation was made by the Company of the probable death rate among the members and of the probable expenses and other liabilities. An account was annually taken and the greater part of the surplus of such premiums over expenditure referable to these policies was returned to the policy-holders as bonuses. The remainder was carried forward as funds in hand to the credit of the general body of the members. It was held that no part of the premium income received under participating policies was liable to be assessed to income-tax as profits or gain, and that *Last* v. *London Assurance Corporation* (2), was distinguishable, the income in that case being derived from transactions with persons not members and not, as in the present case, from mutual insurance between members only.

Mr. Shamair Chand for the assessee submitted that the business of selling sugar, cloth and kerosene oil having been permitted by Government should be treated on par with the business of the Co-operative Society as contemplated by the Co-operative Societies Act, and no distinction can be drawn between one class of business and another and, therefore, profits from wheresoever derived would be exempt under the notification. With this submission I am unable to agree because as was pointed out by Sir Arthur Page, C. J., in the Rangoon case the intention of the Governor-General was to exempt from income-tax under the notification the profits accruing to a Co-operative Society from carrying on the business of a mutual Co-operative Society and upon the ground that a man cannot make profits from himself. It could not have been the intention of the Governor-General to place the Co-operative Society on a higher footing than an ordinary merchant or shopkeeper who would have to pay income-tax on profits gained from sale of sugar

(1) 14 A.C. 381
(2) 10 A.C. 438

etc. The object of giving exemption appears to me to encourage the co-operative business of the Co-operative Societies and not to differentiate in their favour in regard to income-tax.

All these cases go to show that where income is derived by a Co-operative Society from the business of the society as a Co-operative Society the profits are within the exemption given by the Government notification, but where profits arise out of some business even though it may be permitted, but not of the nature which follows out of the objects of the Co-operative Society, then in that case the exemption will not apply.

I am, therefore, of the opinion that the answer to the question which has been referred to us should be in the negative and I would answer it accordingly. The Commissioner of Income-tax is entitled to costs which I assess at Rs. 250.

FALSHAW, J.—I agree.

APPELLATE CIVIL.

Before Falshaw and Kapur, JJ.

GURDIT SINGH AND OTHERS,—*Plaintiffs-Appellants.*

versus

BABU AND OTHERS,—*Defendants-Respondents.*

1953

May, 28th

Regular Second Appeal No. 920 of 1948.

Transfer of Property Act (IV of 1882) Section 10—Family settlement imposing restrictions on sale and mortgage—Whether such restrictions hit by section 10 of the Transfer of Property Act.

A gifted the suit property to F, his *pichhlag* son, in 1879. G. S. and other collaterals of A objected to the gift and in the revenue department a compromise was arrived at between A, F and the collaterals, to the effect that F or his descendants will not sell or mortgage the property but will only be entitled to its usufruct. On 31st August 1944, the descendants of F mortgaged a portion of the land. Collaterals of A challenged the mortgage as being against the compromise. Both courts below dismissed the suit on the ground that the condition imposed by