1940 *Present :* **Keuneman and Cannon JJ.**

PUBLIC SERVICE MUTUAL PROVIDENT ASSOCIATION *v.* COMMISSIONER OF INCOME TAX.

128—(Inty.) Income Tax.

Income tax—Loans given by Provident Association to members—Interest on loans—Taxable profit—Income Tax Ordinance, s. 6 (Cap. 188).

Money earned by the Public Service Mutual Provident Association as interest recovered from loans granted to its members is a taxable profit under section 6 of the Income Tax Ordinance.

CASE stated to the Supreme Court by the Board of Review under section 74 of the Income Tax Ordinance.

The question referred was whether the Public Service Mutual Provident Association is liable to pay Income Tax on interest received from the members of the Association on loans advanced to them by the Association.

E. G. P. Jayetilleke, K.C., S.-G. (with him *H. H. Basnayake, C.C.*), for Commissioner of Income Tax.—The interest earned on the loans to the members of the Association is taxable under section 6 (1) (*a*) and (*e*) of the Income Tax Ordinance (Cap. 188).

The Board of Review upheld the objection of the Association on the authority of two Indian decisions, *viz., Board of Revenue, Madras v. The Mylapore Hindu Permanent Fund*[1] *and the English and Scottish Joint Co-operative Wholesale Society, Ltd. v. The Commissioner of Income Tax, Madras*[2]. Those two cases cannot be relied on. They purport to follow *The New York Life Insurance Co. v. Styles*[3], but in the later case of *The Madura Hindu Permanent Fund, Ltd. v. The Commissioner of Income Tax, Madras*[4], Ramesam J. who had decided the *Mylapore* case admitted that *Styles' case* (*supra*) had no application to the *Mylapore* case.

It was contended on behalf of the respondent Association that the income by way of interest came from the members themselves and, therefore, did not come under the definition of profits and that the transactions in question were carried on on a mutual basis between the corporation and the members. The answer to that contention is that the members who borrowed paid interest not in their capacity as members of the Association but as debtors. There were also debtors who were not members, *e.g.*, Banks. According to the rules of the Association, the members were not bound to borrow. There were, thus, a large number of members who participated in the interest earned without contributing towards it. In order to claim exemption from tax there should be complete identity between the contributors and the participators. The character in which they receive the money should be the same as that in which they paid it.

The present case cannot fall within the ambit of *Styles'* case (*supra*). See *dictum* of Rowlatt J. in *Jones v. South-West Lancashire Coal Owners' Association, Ltd*[5]. A recent decision of the House of Lords in *Municipal Mutual Insurance Ltd. v. Hills*[6] is in point. See also *The Liverpool Corn Trade Association, Ltd. v. Monks*[7].

H. V. Perera, K.C. (with him *F. C. de Saram*), for assessee, respondent.—Section 48 of the Income Tax Ordinance is not superfluous. It would be decisive of this case if we are dealing with a company and its shareholders. In the present case we are dealing not with a company but with a corporation. "Body of persons" as defined in the interpretation section 2 includes a body corporate but excludes a company. A company is not the aggregate of its shareholders, whereas a corporation is the aggregate of its members. A person cannot make a profit out of himself. Similarly, a body corporate, which is the aggregate of all its members, cannot make profit out of itself.

According to the constitution of the Association (*vide* sections 16 and 24 of Cap. 207) a loan to a member does not stand on the same footing as the investment of surplus funds. The former is given in furtherance of the objects of the Association. There is a distinction between a receipt of interest by a body of persons trading with an outsider and an internal receipt by a body from any of its own members. The latter, being derived from members and distributed to members only, is a mutual matter. All the members of the association belong to a class and are entitled

[1] *I. T. C. 217.*
[2] *3 I. T. C. 385.*
[3] *2 T. C. 460.*
[4] *6 I. T. C. 326.*
[5] *11 T. C. 814 at 822.*
[6] *16 T. C. 430.*
[7] *10 T. C. 142.*

to the same privileges. Payments made by a member either by way of subscription or for enjoyment of the privilege of membership go to the common fund and are distributed according to the rules, among the members exclusively. There is thus mutuality notwithstanding the fact that the benefit of the payment of interest made by one or more members does not accrue to the individuals paying but to a class as such. Where there is mutuality there can be no profit. For test of mutuality, see *Jones v. The South-West Lancashire Coal Owners' Association, Ltd.* (*supra*)

When a loan is given to a member in distress the corporation is merely living the life allowed it under the Ordinance. The interest that is sought to be taxed is merely an accretion derived from the internal operations of the Association. It cannot be treated as an income from a source ; enrichment from within is not income from a source.

The principle underlying the decision in *Styles'* case (*supra*) can be easily extended to cover the present case. *Municipal Mutual Insurance. Ltd. v. Hills* (supra) deals chiefly with insurance cases and not with all mutual concerns. All the relevant Indian cases are reviewed in *The English and Scottish Joint Co-operative Wholesale Society, Ltd. v. The Commissioner of Income Tax, Madras* (*supra*). *The Mylapore* case (*supra*) is exactly in point. It has not been overruled in India, nor is there any other case taking a different view. See also *Sunderam on Income Tax* (*3rd. Ed.*), *pp. 245-256.*

E. G. P. Jayetilleke, K.C., in reply.—*Municipal Mutual Insurance, Ltd. v. Hills* (*supra*) is the leading case on what a mutual concern is. The test of mutuality appears in Lord Macmillan's judgment. The term "profits" is defined in *The Mersey Docks and Harbour Board v. Joseph G. Lucas*[1] as incomings after deducting the expenses of earning and obtaining them.

Cur. adv. vult.

April 25, 1940. KEUNEMAN J.—

This is a case stated by the Board of Review. The Commissioner assessed the respondent, The Public Service Mutual Provident Association, for the year 1937-1938 in respect of three items of interest, namely, (1) on Rs. 74,954, unsecured loans to members, (2) on Rs. 51,764, secured loans to members, and (3) on Rs. 12,867, loans to Government and Banks. The total tax payable was assessed at Rs. 3,025. Respondent admitted liability on item (3), but disputed his liability under items (1) and (2), and appealed to the Board of Review. That body upheld the contention of the respondent and ordered that the assessment should be corrected by the deletion of items (1) and (2). The tax payable was thus reduced by the sum of Rs. 2,745.80. The matter now comes before this Court.

The respondent is a body incorporated under Chapter 207 of the Legislative Enactments (Ordinance No. 5 of 1891 and subsequent enactments). The general objects of the corporation appear in the preamble and in section 3, namely, "to promote thrift, to give relief to the members in times of sickness or distress, to aid them when in pecuniary difficulties, and to make provision for their widows and orphans". Section 22 provides for the vesting of property in the corporation ; section 27

[1] *2 R. 8 A. C. 891.*

provides that the corporation may hold property movable or immovable; section 24 makes it lawful for the Committee of Management to place the whole or any part of the surplus funds belonging to the corporation and not required for loans, advances, and other current expenses, in fixed deposit in the local banks, or to invest the same in certain Government or Municipal securities; and section 16 provides for the making of rules at any general meeting of the Association.

The rules of the Association have been put in—document A. These provide, *inter alia*,—

(*a*) for the grant of loans to members up to one-half of the amount standing to their credit in the books of the Association (Chapter I., Rule 12);

(*b*) for the grant of loans for the purpose of relieving members at a time of sickness or distress, or of aiding them in pecuniary difficulties, to the extent of either one month's or two months' salary or pension according to the standing of the member (Chapter I., Rule 13);

(*c*) for the grant of loans to members on the security of landed property up to one-half of the appraised value of the lands (Chapter II., Rules 1 and 4).

Each of these classes of loans carries interest at six *per centum per annum*.

The Board of Review, by a majority decision, held that the respondent Association was a body of individuals banded together for mutual help, that the loans to members were in furtherance of the objects of the Association and advanced out of the common fund formed by the contributions of all the members, that the interest from loans to members was earned by the mutual fund, and that this sum (less expenses) was divided between the members in their capacity of members or contributors to the mutual fund (from which the loans were made), and not in any capacity analogous to that of shareholders of a limited liability trading company. The Board depended mainly on the decisions in three cases, namely,

(1) *The New York Life Insurance Co. v. Styles*[1];

(2) *Board of Revenue, Madras v. The Mylapore Hindu Permanent Fund, Ltd.*[2]; and

(3) *The English and Scottish Joint Co-operative Wholesale Society, Ltd. v. The Commissioner of Income Tax, Madras*[3].

The case most nearly related to the present one is the Mylapore case, where a mutual benefit society registered under the Companies' Acts had its share capital subscribed entirely by its members by way of periodical payments, and the income of the fund was derived chiefly from interest earned on overdue subscriptions or on loans given exclusively to its members, who were entitled under the rules to take loans, and also from interest from outside investments with banks. The principle enunciated in this case is that income to be taxable must come from outside and not from within, and that the fact that the Fund is a

[1] *2 T. C. 460.* [2] *1 I. T. C. 217.*

[3] *3 I. T. C. 385.*

legal entity for certain purposes does not matter, and that a person cannot make a profit or loss out of himself. It was held therefore that interest obtained from members was not taxable, although interest derived from investments in banks was taxable.

Ramesam J., who delivered the judgment of the Court, held that this case was governed by the case of *The New York Life Insurance Co. v. Styles (supra)*.

The Mylapore case would be of some authority but for one infirmity inherent in it. In a later case, namely, *The Madura Hindu Permanent Fund, Ltd. v. The Commissioner of Income Tax, Madras*[1], it was held, in considering the Mylapore case, that Styles' case had no application to it, and that the Mylapore case could not be based upon it. Ramesam J. himself admitted that the actual decision in Styles' case did not apply to the Mylapore case, but he added that the Mylapore case was not wrongly decided, apparently on the ground that the observations made by their Lordships in Styles' case supported the result arrived at. In the circumstances, I think it is necessary for us to consider Styles' case, and to see whether the reasoning in that case causes us to arrive at the same conclusion. I may add that the same criticism applies to the other Indian case relied upon by the Board of Review, namely, The English and Scottish Co-operative Society case.

I shall next consider Styles' case. A mutual life insurance company had no members other than the holders of participating policies, to whom all the assets of the company belonged. At the close of each year an actuarial valuation was made, and if the aggregate receipts of the company were more than the expenses and the estimated liabilities, the surplus was divided between the policy-holders who received a premium in the shape of either a cash reduction from future premiums or a revisionary addition to the amount of their policies. It was held that so much of the surplus as arose from excess contributions of the participating policy-holders was not profit assessable to income tax.

I am of opinion that the principle decided in Styles' case is, as stated in the judgment of Lord Watson, "When a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities or of capital sums to some or all of them, on the occurrence of events certain or uncertain, and stipulate that their contributions, so far as not required for that purpose, shall be repaid to them, I cannot conceive why they should be regarded as traders, or why contributions returned to them should be regarded as profits." Similarly, Lord Herschell says, "The members contribute for a common object to a fund which is their common property; it turns out that they have contributed more than is needed, and therefore more than ought to have been contributed by them for this purpose, and, accordingly, the next contribution is reduced by an amount equal to their proportion of the excess. I am at a loss to see how this can be regarded as a "*profit*" arising or accruing to them from a trade or vocation which they carry on."

[1] *6 I. T. C 326 at 332.*

In the later case of *Municipal Mutual Insurance, Ltd. v. Hills*[1] Lord Macmillan laid down the principle of Styles' case as follows :—

"The principle on which the surpluses arising in the conduct of a mutual insurance scheme are not taxable as profits is now well understood. The essence of the matter is that a number of persons who are exposed to some contingency, whether the inevitable contingency of death or such possible contingencies as fire, employees' claims, marine casualties or the like, associate themselves together as contributors to a common fund on the footing that if the contemplated contingency befalls any contributors he or his representatives shall receive a compensatory payment out of the common fund proportional to his contribution. The scale of contributions or premiums is fixed on experience and estimates. If it is found to yield more than enough to satisfy the claims that emerge, the contributors receive the entire benefit in the shape of bonuses, reduction of future contributions or otherwise. As the common fund is composed of sums provided by the contributors out of their own moneys, any surplus arising after satisfying claims obviously remains their own money. Such a surplus resulting merely from miscalculation or unexpected immunity cannot in any case be regarded as taxable profit."

In my opinion, the present case has features which are not possible to reconcile with the Styles' case, as so interpreted. The present appeal does not deal with the question of any surplus remaining over as the result of miscalculation or unexpected immunity. What takes place in the case of our Society is that money is lent to members at six per cent. interest. It is clear that the volume of these transactions is large, and for the year in question in this case a sum of more than two million rupees has been so loaned to members. It is difficult to resist the conclusion that the Society carries on a business with its members in respect of these loans, in point of fact a bigger business than with the Government and the Banks. Can the return received by the Society from this business by way of interest be regarded as otherwise than a taxable profit ?

In this connection I may cite a *dictum* of Rowlatt J. in *Jones v. The South-West Lancashire Coal Owners' Association, Ltd.*[2].

"The principle laid down in the *New York Insurance Company case* is that no one can make a profit out of himself . . . . . It is true to say that a person cannot make a profit out of himself, if what is meant is that he may provide himself with something at a lesser cost than that at which he could buy it, or if he does something for himself instead of employing somebody to do it. He saves money in those circumstances, but he does not make a profit. 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 its 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."

[1] *16 T. C. 430.*

[2] *11 T. C. 814. at 822.*

Vide also *The Liverpool Corn Trade Association, Ltd. v. Monks*[1] where a similar point was decided.

With respect, I do not think that in the case of a Society doing business with its own members in the way of loans, and earning interest on such loans to members, there is present the mutuality which existed in Styles' case. I cannot distinguish between the present case and that of a railway company carrying its own members, or a trading company selling to its own members, and making a profit thereby; and with all deference, I cannot see any decision in Styles' case or in the subsequent cases decided in England, which makes me come to a different conclusion. I think that the amount earned by the Society as interest from loans to its members is a taxable profit obtained from a business.

It was strenuously argued by counsel for the respondent that because the object of the Society was to give loans to members, and because the loans were obtained by virtue of their membership, therefore all interest received was to be regarded as an internal accretion, and that the element of mutuality was established. I do not think this argument can be sustained. In my opinion, the interest was paid by the member *qua* borrower, and the interest paid helped to swell the resources of the whole body of members, *qua* members. There was not that mutuality which exists between members who pay contributions for a common purpose and receive back the excess after the deduction of necessary expenditure. In the latter case the money is paid and received back in only one capacity, namely, that of members. In other words the members are receiving back what has always been their own, and that cannot be regarded as a profit.

Counsel for the respondent also relied on Jones' case, and in particular on the *dictum* of Rowlatt J.:

> "The broad principle was there (*i.e.*, in Styles' case) laid down that, if the interest in the money does not go beyond the people or *the class of people* who subscribed it, then, just as there is no profit earned by the people subscribing, if they do the thing for themselves, so there is none if they get a company to do it for them."

It was argued that the interest earned here was earned from members and enured to the benefit of members of the same class. I do not think that is the true interpretation of the words. Rowlatt J. was dealing with the possible distinction between the body of members and the corporation. What this case established was that where surpluses were available after deduction of expenditure from the contributions of the members, it did not matter whether these surpluses were paid back immediately or carried to a fund the benefits of which would be available to members who joined subsequently and who had not made the original contributions. But the fundamental facts of that case were that the contributions were originally made by the members *qua* members, and the benefits of the fund were available to them subsequently in the same capacity, and the principle in Styles' case was held to be applicable. No doubt the principle enunciated in Styles' case may be regarded, as the respondent says, as carried one step further, but I do not think that step has been taken in the direction which the respondent contends for.

[1] *16 T. C. 430.*

I am accordingly of opinion that the interest obtained both in the case of the secured loans and of the unsecured loans is a taxable profit. I allow the appeal, set aside the order of the Board of Review, and restore the items which have been deleted by the Board.

The appellant is entitled to the costs of appeal.

CANNON J.—

This is a case stated by the Board of Review under the Income Tax Ordinance, No. 2 of 1932 (s. 74) for the opinion of this Court as to whether the Public Service Mutual Provident Association is liable to pay income tax in interest received from the members of the Association on the loans advanced to them by the Association. The Association appealed to the Board of Review against the decision of the Income Tax authorities to assess this interest for taxation. The Association contended that the Association is not a business concern and that the loan transactions were oetween the members of the Association themselves in pursuance of the provident objects of the Association on a mutual basis, in that the interest paid by the members who took loans was returned to the members by being distributed as a dividend to the account of every member; and that therefore the interest derived from the loans did not come within the statutory definition of profits—Ch. 188 Sec. (6).

The Board by a majority upheld the objection of the Association and upon the application of the Commissioner stated a case for the opinion of this Court, the question for decision being whether interest derived from loans to members constitutes taxable profits or income under the Income Tax Ordinance.

The material facts set forth in the case stated are as follows:—

"The Public Service Mutual Provident Association, which is a body corporate constituted by Ordinance No. 15 of 1891, Chapter 207, was assessed under the Income Tax Ordinance, 1932, for the Year of Assessment 1937-1938, as being liable to pay Income Tax on a total investment income of Rs. 139,585 which included a sum of Rs. 126,718 being the amount of interest derived by the Association from loans to members, in the year preceding the year of assessment. The tax payable on this amount of interest (if the Association is liable to pay tax on it) is Rs. 2,745.80. The tax payable on the total investment income of Rs. 139,585 is Rs. 3,025.80. The amount of the tax in dispute on this appeal is the said sum of Rs. 2,745.80.

The Association was constituted for the general objects of promoting thrift, of giving relief to members in times of sickness or distress, of aiding them when in pecuniary difficulties and of making provision for their widows and orphans—section 3. Rules have been framed by the Association under the powers given by section 16. Under the Rules the Committee of Management may grant loans to a member to the extent of one-half of the nett amount standing to the credit of such member in the books of the Association. The Association can also make loans to members on the security of landed property to an amount not exceeding one-half of the appraised value of the property. Interest is payable by members on both types of loan made to them by the Association at 6 per cent. per annum.

The accounts of the Association, for the relevant period, show that Rs. 2,114,850 had been lent to members and Rs. 633,026 had been invested in Government Securities and Fixed Deposits in various Banks. Of the total loans to members, Rs. 822,054 had been lent to members against mortgages of landed property. Of the total sum of Rs. 126,718 received as interest from members Rs. 51,764 was the interest from secured loans.

No question as to the liability of the Association to pay income tax on the income derived from the investments in Government Securities and Fixed Deposits had been raised ; it admits its liability to pay tax on that income.

The Association, however, disputed its liability to pay tax on the sum of Rs. 126,718. "

For the Income Tax authorities, Mr. E. G. P. Jayatilleke, K.C., the Solicitor-General, pointed out that under the Rules made by the Association requiring interest at 6 per cent. to be paid by members for loans, such of the Rules as deal with the lending of money to members on mortgage do not stipulate that the mortgagee shall be in pecuniary difficulties. The lending of money on interest forms a material part of the activities of the Association, the loans totalling Rs. 2,114,850 for the year in question, those secured bringing in interest a sum of Rs. 51,764 and those not secured an amount of Rs. 74,954. Counsel contended that as the interest earned was distributed not only to those who paid it but also to the other members, there was no mutuality as between those members who paid and those who received. Members were not compelled by the Rules to borrow, and as only some of them took up loans, those who did not do so nevertheless shared in the income derived from the interest to which they were not contributors. Such income therefore became profit liable to taxation. He relied upon *Municipal Mutual Insurance, Ltd. v. Hills*[1] *and Liverpool Corn Trade Association, Ltd. v. Monks.*[2]

Mr. H. V. Perera, K.C., for the Association took the point that the Association was a body of persons distinct from a trading company and submitted that section 48 of the Income Tax Ordinance had in that case no application to the Association. Section 48 reads :—

"The profits of a company from transaction with its shareholders which would be assessable if such transactions were with persons other than its shareholders shall be profits within the meaning of this Ordinance ".

Counsel next argued that the purpose of the loans was not the making of a profit but the carrying out of one of the objects for which the Association was formed, namely, to aid its members when in pecuniary difficulties ; and that since any income which resulted from such money-lending transactions was derived from members and distributed to members only, it was a mutual matter and not a business transaction, as it would have been, had the transactions been with non-members. The fact that some members participated in the income derived from interest but did not contribute to that income did not, he submitted, make it a

[1] *16 T. C. 430.*

[2] *10 T. C. 442.*

profit for the reason that the income did not come from an outside source. It was, he argued, a mere receipt of money which was an accretion derived from the internal operations of the Association in carrying out one of the objects of its existence, namely, lending money to members in need to aid them and not to gain profit. It was " the body of persons " who were taxed, but the enrichment of that body by internal functioning of its operations, according to its objects, was not income derived from a transaction with the outside world and therefore was a matter of mutuality and not business. The borrowing member took the loan in his capacity as a member, not *qua* borrower or debtor. Though all members did not avail themselves of the right to borrow, they were entitled to exercise that right or privilege and consequently there was mutuality between those who did and those who did not borrow. The income need not go back to the identical members who contributed it; it was sufficient if it went to the class of people who did so, namely, all those who were members of the Association at the time of the distribution. He relied upon *New York Life Insurance v. Styles*[1], *Board of Revenue, Madras v. Mylapore Permanent Fund, Ltd.,*[2] *and Jones v. South West Lancashire Coal Owners' Association, Ltd.*[3]. My brother Keuneman has in his judgment analysed the *ratio decidendi* of these and the other cases cited.

The cases supported Mr. Perera's contentions generally—that a transaction which is restricted to the members of the Association has the character of a mutual transaction and that there is no necessity for the "income" to be returned to the identical people who contributed it. The point, however, remains that while the loans made by this Association are taken from the common fund, the interest is not paid out of a common fund, and, in my view this fact negatives mutuality—see *Municipal Mutual Insurance, Ltd. v. Hills* (*supra*)—and this independently of any distinction that may be drawn between the Association as a trading company and as a body of persons incorporated for provident purposes. Whether or not the lending of money at 6 per cent. interest to members (as distinct from investments of surplus money) can properly be said to be carrying out the object of the Association of aiding its members when in pecuniary difficulties is, in my opinion, arguable, but the legality of the Rules permitting this and which were made by the Association is not raised by the case stated. The lending of money is obviously not a minor part of the Association's activities and the rate of interest charged can hardly be characterized as a non-commercial rate. By receiving income from interest which they do not contribute, though they contribute to the common fund from which loans are made, non-borrowing members make a benefit at the expense of the other contributors who do borrow, and I would say that all income derived from such interest constitutes taxable income of the Association under the Ordinance.

I agree that this appeal should be allowed with costs.

Appeal allowed.

[1] *2 Tax Cases 460.*

[2] *I Indian Tax Cases 217.*

[3] *11 Tax Cases 814.*