

(1945) 04 CAL CK 0001

In the Calcutta High Court

Case No : Income-tax Reference No. 23 of 1942

English and Scottish Co-operative Wholesale Society Ltd. and
another

APPELLANT

Vs

Commissioner of Agricultural Income Tax, Assam

RESPONDENT

Date of Decision : 24-04-1945

Acts Referred:

Citation : (1945) 04 CAL CK 0001

Judgement

Gentle, J.—This is a reference by a member of the Board of Agricultural income tax, Assam, pursuant to S. 28 (1) of the Assam Agricultural income tax Act 1989 (hereinafter called "the Assam Act"), and is with regard to the English and Scottish Joint Co-operative Wholesale Society Ltd, (hereinafter called "the Society"). The question which this Court is required to answer is :

Whether the Society is chargeable to Assam Agricultural income tax in respect of the cultivation and/or manufacture of tea at its Deckiajuli Estate in the Province of Assam and sold to its members?

2. Agricultural income is defined, so far as is material, in the Indian income tax Act as follows :

3. Section 2 (1) "agricultural income means, (b) any income derived from such land by (i) agriculture."

"Such land" in (b) is land which is used for agricultural purposes. By S. 4 (3) (viii) of the same Act agricultural income is not chargeable to income tax. Section 2 (a) (2) (i) of the Assam Act defines agricultural income identically as it is defined in the income tax Act. An explanation to the section provides that:

Agricultural income derived from such land by the cultivation of tea means that portion of the income derived from the cultivation, manufacture and sale of tea as is defined to be agricultural income for the purposes of the enactments relating to Indian income tax.

3. Rule 24 of the Rules under the Indian income tax Act provides that:

Income derived from the sale of tea grown and manufactured by the seller in British India shall be computed as if it were income derived from business and 40 per cent of such income shall be deemed to be income, profits and gains liable to tax.

4. Section 8 (1) of the Assam Act provides that agricultural income, as defined by S. 2 (a) (2) (i), shall be assessed on the net amount of such income determined by Rules under the Act prescribing the manner of determination. A proviso to S. 8 is as follows:

Provided further that in cases of agricultural income from cultivation and manufacture of tea the agricultural income for the purpose of this Act shall be deemed to be that portion of the income from cultivation, manufacture and sale which is agricultural income within the meaning of the Indian income tax Act and shall be ascertained by computing the income from the cultivation, manufacture and sale of tea as computed for Indian income tax from which shall be deducted any allowances by this Act authorised in so far as the same shall not have been allowed in the computation for the Indian income tax Act.

5. Rule 5 of the Assam Agricultural income tax Rules. 1939, provides that :

In respect of the agricultural income from tea grown and manufactured by the seller in the province of Assam, the portion of net income worked out under the Indian income tax Act and left unassessed as being agricultural shall be assessed under this Act after allowing such deductions under the Act and the rules made thereunder so far as they have not been allowed under the Indian income tax Act in computing net income from the entire operation.

By reference to R. 24 of the Indian income tax Rules, S. 8 (1) and the proviso to that section of the Assam Act and R. 5 of the Assam Rules, it is contended, on behalf of the Commissioner of Agricultural income tax, Assam, that agricultural income chargeable to tax under the Assam Act is 60 per cent, of the income derived from the sale of tea grown and manufactured upon the Society's estate less any deduction, permitted by the Assam Act, which has not been allowed 60 per cent, is the difference between the whole and 40 per cent, of the income derived from the sale of tea, the latter percentage being chargeable to income tax by virtue of R. 24. This method of ascertainment of the amount of agricultural income is not questioned by the Society but, it contends, it is not chargeable to tax.

6. The charging section of the Assam Act is S. 3 which provides that :

Agricultural income tax at the rate or rates specified in the Annual Assam Finance Acts subject to the provisions of S. 6 shall be charged for each financial year in accordance with and subject to the provisions of this Act on the total agricultural income of the previous year of every individual Hindu undivided or joint family, company, firm and other Association of individuals.

Section 6 gives the limits of taxable agricultural income. It is desirable to correct a misstatement, in Para. 9 of the Reference, that the Society is not chargeable to income tax in the United Kingdom. The Society is registered in England under the Industrial and Provident Societies Act, 1893. Section 24 of that Act exempted profits of societies registered under it from income tax unless they sold goods to persons other than members. This section was repealed by the Finance Act, 1918, and its provisions were re-enacted in S. 39 (4) of that Statute. Section 39 (4) was repealed by S. 31 (2), Finance Act, 1933. Since the year 1933 the profits of registered societies have been chargeable to United, Kingdom income tax. Section 60 (1) of the Indian income tax Act empowers the Central Government, by Notification, to make exemptions in respect of income tax By Notification, under the above sub-section, the profits of co operative societies, registered under the Acts mentioned in the Notification, are exempted from Indian income tax similarly as they were formerly exempted in England. The Society is not registered under any of the specified Acts and is not entitled to the benefit of the Notification. By a decision of the Madras High Court, 3 I. T. c. 385 *English & Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of income tax, Madras* ("29) 3 I. T. C. 385 (Mad.), it was held that the profits of the Society, concerned in the present Reference, are not chargeable to Indian income tax. This immunity is quite apart from the exemption given to registered societies by the Notification under S. 60 (1), income tax Act.

7. As previously mentioned the Society is incorporated in the United Kingdom under the Industrial and Provident Societies Act, 1893; it has an unlimited capital divided into shares of ₹5 each. It is non-resident in British India. Its objects, as set out in its rules, inter alia, are : "To carry on the business of planters, growers, producers, merchants and manufacturers and brokers of tea." The Society consists of two members, namely the Co-operative Wholesale Society Ltd., and the Scottish Co-operative Wholesale Society Ltd. The Society owns the Deckiajuli Estate where it grows and manufactures tea. Except a small portion of the produce, which is unfit for export and which is sold locally, the whole of the Society's output of tea is sold to its two members at market rates and is exported to England and Scotland. Each year the members of the Society pay, by way of advances, to the Society sums of money to meet the cost of tea to be supplied by the Society to the members. The market prices of the tea, with which the members are supplied, are debited against these payments. The supplies are recorded as sales to the members. Out of the proceeds from the sales, the expenses of production and management and the interest on loans are paid or provided. By the rules of the Society its net profits are applied : (a) in depreciation of land (except agricultural land and tea gardens), buildings, live and rolling stock; (b) payment of interest not exceeding 6 per cent, per annum on the share capital; (c) appropriation to a reserve fund; (d) appropriation to a special fund for making grants as determined in general meeting; (e) payment of a dividend to members rateable to proportion to the amount of purchases made by them from the Society; and (f) the remainder, if any, carried forward to the

next account.

8. The learned Advocate-General, on behalf of the Society, contended that no profit can be made by an association trading with itself; the transactions of the supply of tea by the Society to its two members are not sales to the members; there is no profit, derived from those transactions, which is chargeable to tax; such transactions are mutual dealings between the Society and the members and are transactions by the Society with itself; by distributing the surplus moneys, in the six ways above mentioned, including paying to the members a dividend of 6 per cent, per annum upon the amounts of their respective shares in the Society and making a further payment to them commensurate with the quantities of tea which they respectively purchase from the Society, the Society is merely returning to them the sums which they have each paid to the Society in excess of the value of the quantities of tea supplied to them. In support of these propositions reliance was solely placed upon 3 I. T. C. 385 *English & Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of income tax*, Madras ("29) 3 I. T. C. 385 (Mad.). Before discussing this case, it is convenient to refer to two decisions of the House of Lords in England: (1885) 10 A. C. 438 *Last v. London Assurance Corporation* (1885) 10 A. C. 438 : 55 L.J.Q.B. 92 : 53 L.T. 634 : 34 W. R. 233 and (1889) 14 A. C. 381 *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201. In *Last's* case *Last v. London Assurance Corporation* (1885) 10 A. C. 438 : 55 L.J.Q.B. 92 : 53 L.T. 634 : 34 W. R. 233 an insurance company issued ordinary policies and also participating policies at increased premia. At the end of every five years the gross profits of the participating policies were dealt with by returning to the holders of these policies 2/3rd by way of bonus or abatement of premium, the remaining 1/3rd going to the company which bore the expenses of the undertaking, and the balance left, after paying expenses, was the only profit distributable amongst the share-holders of the company. It was held that the company was chargeable to income tax upon the 2/3rd returned to the holders of participating policies.

9. In *Style's* case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201 an insurance company had no shares or share-holders, the members of the company were the holders of participating policies who were entitled to a share in the assets, and liable to all losses, of the company. At the commencement of each year the company calculated the amount it expected to require for the ensuing 12 months to meet expenses and to make payments upon its matured policies. Each participating policy holder subscribed his proportion of that amount. At the end of one year, after discharging all outgoings, a balance remained which was returned to the participating policy holders either by addition to the sum insured or in reduction of future premium. It was held that the amounts of the over-payments in respect of anticipated expenditure, which were returned to the subscribers, were not profits chargeable to tax. At p. 394 Lord Watson observed:

When a number of individuals agree to contribute funds for a common purpose, such as the payment of annuities, or 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.

10. In Last's case *Last v. London Assurance Corporation* (1885) 10 A. C. 438 : 55 L.J.Q.B. 92 : 53 L.T. 634 : 34 W. R. 233 the company distributed the profits which it had made upon the business it transacted; this profit was held to be chargeable to income tax. In Style's case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201 there was not a distribution of profits but the portion of a fund which was not utilised for the purpose for which it was subscribed was returned to the persons who had provided it; this residue was not profit, and therefore, was not chargeable to tax. In 3 I. T. C. 385 *English & Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of income tax, Madras* ("29) 3 I. T. C. 385 (Mad.) (of which mention has been made) the facts were identical with those in the present Reference and the question which arose was the Society's liability to tax under the Indian income tax Act. The Madras High Court considered that it fell within the ambit of Style's case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201 and that the principles in Last's case *Last v. London Assurance Corporation* (1885) 10 A. C. 438 : 55 L.J.Q.B. 92 : 53 L.T. 634 : 34 W. R. 233 were inapplicable. It was held that the Society was purely a mutual concern; the whole of its produce (except a small portion sold in India and in respect of which admittedly income tax was payable upon profits) was distributed amongst its members; the distribution of its surplus in the six ways (set out above) was purely a notional division of profits; this was merely a handing back of a portion of the amounts subscribed by the members and was in no sense a dividend on the profits earned by the Society; and the Society was not chargeable to income tax upon the sums paid to its members. The correctness of this decision appears subsequently to have been doubted by the Madras High Court: vide the observations of Sir Owen Beasley C. J. at p. 425 in 56 Mad. 415 *Commissioner of income tax, Madras v. Madura Hindu Permanent Fund Ltd.* ("33) 20 A. I. R. 1933 Mad. 347 : 56 Mad. 415 : 143 I.C. 894 (F.B.).

11. The observations of Rowlatt J. in two cases in the Courts in England can now be given. In (1927) 1 K. B. 33 *Thomas v. Richard Evans & Co. Ltd.* (1927) 1 K. B. 33 : 95 L. J. K. B. 990 : 135 L. T. 673 at pp. 46 and 47, the learned Judge explains the position when a company transacts business with its members. He said

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 any other 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; 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 matters not 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 Style's case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201, there is no profit.

In (1926) 2 K. B. 110 *Liverpool Corn Trade Association v. Monks* (1926) 2 K. B. 110 : 95 L. J. K. B. 519 :134 L. T. 756, the same learned Judge observed, at pages 121 and 122, that "if there were a railway company which only carried its own shareholders one would say that, when it afforded the advantage to a shareholder of performing an act of transmit for him, being paid by the shareholder therefor, that the profit thereby made was a profit of the company just as much as if the shareholder was a stranger." In that case a company was formed with the object of promoting the interests of the corn trade; its members were confined to persons engaged in that trade; the company provided various facilities for carrying on business of the trade; fees were charged to members and others making use of the facilities; the bulk of the receipts were received from entrance fees and subscriptions paid by the members. Rowlatt J., at p. 121, pointed out that the question was whether the profit which the company made out of what the members paid to it was taxable income of the business which the company undoubtedly carried on. It was held that the company was not a mutual association whose transactions with its members were incapable of producing a profit; it carried on a trade, the profit of which were assessable to income tax.

12. It is now convenient to return to the facts in the present reference. The Society carries on business in British India as growers, manufacturers and sellers of tea. Each year its two members advance to the Society sums of money to be utilised to pay for the tea which it grows and manufactures and then sells to them (the small quantity of inferior tea sold in India can be ignored). The sales by the Society to its members result in an excess of receipts over expenditure and this is profit made by the Society upon its trading. The profit is distributed in six ways, including payment to each member of interest at 6 per cent, upon the amount of his shares in the Society and a further distribution to each of a sum rateably in proportion to the amount of tea bought from the Society.

13. In the Madras decision the above facts were considered to fall within the ambit of Style's case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201. In that case the sums subscribed by the members were solely for the purpose, and were solely utilised, to meet the obligations of the company to other members i. e., maturing policies, and to pay the expenses of the company; the company did not supply the members with goods or anything else in exchange for the monies it received; and there was no

profit arising from the transactions between the company and its members; the balance which remained after discharging its liabilities, out of the money subscribed to meet the liabilities, was returned to those who had provided the finance. The monies which were returned were not distributions among the shareholders of profits made from trading. The contention, that the transactions between the Society and its members are not sales, ignores the facts set out in the reference. In para. 7 it is stated that the produce of tea raised by the Society is sold to its members and, in para. 6 (e), the rules of the Society provide for payment of a dividend to the members rateable in proportion to the amount of the purchases made by them from the Society. Further, in para. 11, the question of law for decision is whether the Society is chargeable to tax in respect of tea sold to its members. It is beyond doubt that the Society sells tea to its members. It has next to be considered whether the sales of tea by the Society to its members are transactions by the Society with itself. As above mentioned, the Society is a registered society under the English Industrial and Provident Societies Act, 1893, S. 24, of which provides, so far as is material, that:

The registration of a society shall render it a body corporate by the name described in the acknowledgment of registry, by which it may sue and be sued, with perpetual succession and a common seal and with limited liability.....

14. The argument, as I understand it, that a sale by the Society to one of its members is a "mutual dealing" suggests that, because of the relationship of society and member, a contract of sale and purchase is not made between them since the member and the society are one and the same entity and, consequently, the society is transacting with itself when it sells to a member of the society. A registered society is a body corporate, the holders of its shares are called members and not share-holders but shareholders in a company are members of the company and are frequently referred to as such. Both a registered society and a company incorporated under the Companies Act are bodies corporate. A member of a registered society is in the same position as regards the society as is the share-holder of a company with respect to that company. The share-holder and the company are separate and distinct entities, even when one share-holder is the proprietor of 20,000 out of 20,007 issued shares, the remainder being held by several of his relations: vide 1897 A. C. 22 *Salomon v. Salomon & Co., Ltd.* (1897) 1897 A.C. 22 : 66 L. J. Ch. 35 : 75 L.T. 426 : 45 W. R. 193. When a person buys goods from a company, of which he is a share-holder, the transaction between them is made in their individual characters and each is a separate party to the contract. The relationship of share-holder and company is quite apart from the sale and purchase agreement. The nature of the transaction is the same as a similar transaction between the company and a person who is not a share-holder. When a company sells goods to a share-holder it does not effect a transaction with itself any more than it does when it sells to a non-share-holder. When the Society sells tea to its members the relationship between them is that of seller and buyer in an ordinary contract for the sale of goods and the society does not transact business with itself. The transactions

between the Society and its members are not similar to, or of the nature of, those in Style's case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201 but they are transactions of sale on the one hand and purchase on the other hand. The payments by the members to the Society are not subscriptions to a fund out of which its liabilities are to be discharged and the balance, if any, to be returned to the subscribers, but they are payments in advance for tea which is to be sold to them by the Society, and are the purchase prices for those goods. There is no surplus, left from those payments; returnable to the members. The moneys which the Society distributes amongst, and pays to, the members are the profits derived from its business of growing, manufacturing and selling tea to its customers, who are also its members. When making such payments the Society does not return unutilised balances remaining from the payments it has received from its members.

15. I am, with respect, unable to agree with the opinion expressed in 3 I.T.C. 385 *English & Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of income tax, Madras* ("29) 3 I. T. C. 385 (Mad.) that: the facts in that case (which are identical with those in the present Reference) fall within the ambit of Style's case *New York Life Insurance Coy. v. Styles* (1889) 14 A. C. 381: 59 L.J.Q.B. 291 : 61 L.T. 201; the payment by the Society to its members of a dividend upon their shares in the Society and the payment to them (as purchasers from it) of a further dividend rateable in proportion to the amounts of their purchases from the Society, are merely a handing back of a portion of the amounts subscribed by the members to the Society; and the payments are in no sense dividends on the profits earned by the Society. In the view which I hold, the Society is a trading concern and carries On business, as growers, manufacturers and sellers of tea; out of this business it derives profits; the dividends which it pays to its members are a distribution amongst them of its trading profit; and the payments of these dividends are not a return to the members of balances from the sums which they have subscribed to the Society. The facts in this Reference fall within the ambit of Last's case *Last v. London Assurance Corporation* (1885) 10 A. C. 438 : 55 L.J.Q.B. 92 : 53 L.T. 634 : 34 W. R. 233 and are analogous to those in (1926) 2 K.B. 110 *Liverpool Corn Trade Association v. Monks* (1926) 2 K. B. 110 : 95 L. J. K. B. 519 :134 L. T. 756 and are covered by the observations of Rowlatt J. (quoted above) in the latter case. The same learned Judges observations in (1927) 1 K.B. 33 *Thomas v. Richard Evans & Co. Ltd.* (1927) 1 K. B. 33 : 95 L. J. K. B. 990 : 135 L. T. 673 are also in point. The circumstance that the Society's produce is sold to its members does not affect the position and would not do so even if the Society were restricted to selling to its members alone. The profit to the extent of 60% thereof less permitted deductions which is distributed and paid by the Society in the six ways provided by the rules, is agricultural income as defined by S. 2 (a) (2) (i), Assam Act. The Society is not registered under any of the Acts in respect of which exemption from liability to income tax is given by the Notification under S. 60, (1). income tax Act, and, therefore, it is not entitled to the benefits given by the

Notification. It has not been argued nor considered whether, if registered under any Indian Act, the Society would be exempted from agricultural income tax under the Assam Act. I would answer in the affirmative the question of law which arises for decision in this Reference.

Derbyshire, C. J.

16. I agree.