

INFORMATION MEMORANDUM :

In a recent ruling, the Apex Court held that "Doctrine of Mutuality" bestows a special status to qualify for exemption from tax liability. Where a non-member was a contributor, one member had an option not to contribute and management was vested in that member's hand, the said doctrine stood defeated.

Yum! Restaurants (Marketing) Pvt. Ltd. v. CIT Civil Appeal no. 2847 of 2010 (SC), order dt. 24th April, 2020

"Doctrine of Mutuality" bestows a special status to qualify for exemption from tax liability.

Facts of the case :

The appellant is a wholly owned step down subsidiary of YRIPL for undertaking the activities relating to Advertising, Marketing and Promotion ("AMP activities") with YRIPL and its franchisees in terms of Tripartite Agreement, for the mutual benefit of the parent company and the franchisees. The appellant received fixed contributions to the extent of 5% of gross sales from the franchisees for the proper conduct of the AMP activities. As per the order of Secretariat for Industrial Assistance ("SIA"),

the assessee company was obligated to operate on a "non-profit basis".

Appellant filed its returns declaring "Nil" income on the ground of doctrine of mutuality. The AO and subsequent authorities rejected the claim on the ground:

- a) Activity had taint of commerciality since non-member Pepsi joined as contributor.
- b) YRIPL is not under any obligation to contribute as per terms of Tripartite Agreement and;

c) Contributions is also received from M/s Pepsi Foods Ltd. which is neither a “franchisee” nor a “beneficiary”.

The consistent line of opinion recorded by the aforementioned three forums was further approved in appeal by the High Court.

Question before Supreme Court :

Whether the activity of assessee company would qualify under the “Doctrine of Mutuality” so as to exempt the surplus of appellant as non-taxable?

Appellant’s submission :

The appellant relied upon the SIA order and the agreements with the franchisee and YRIPL to contend that:

- (i) it carried on the earmarked activities on a non-profit basis on behalf of its members;
- (ii) it operated strictly for the benefit of the contributors to the mutual concern ;
- (iii) it does not levy any charge on the franchisees for carrying out the operations ;
- (iv) doctrine of mutuality merely requires an identity between the contributors and beneficiaries. It does not contemplate that each member should contribute to

the common fund or that the benefits must be derived by the beneficiaries in the same manner or to the same extent.

Supreme Court verdict :

The Apex Court, in a detailed decision, rejected the claim of doctrine of mutuality advanced by the Appellant. It held that the appellant had violated the principle of mutuality as laid down in the case of *The English and Scottish Joint Cooperative Wholesale Society Ltd. v. CIT AIR 1948 PC 142*) and *CIT v. Bankipur Club Ltd. (1997) 5 SCC 394* which lay down the tests for applying the doctrine of mutuality. The apex court recorded adverse finding that:

- a) the management and control and decision making was vested with the holding company YRIPL and not with the contributors.
- b) As per agreement with YRIPL it had an option not to contribute to the appellant for the AMP services which is against the principle of all participants must contribute.
- c) The transaction with Pepsi was commercial in nature as though Pepsi contributed, it could not participate in the surplus. Hence, the said transaction was not with the participant.

Alternative ground by appellant : The Appellant also argued that it merely holds the funds as a trustee and is under an overriding obligation to spend such contributions received for AMP activities for mutual benefit of the contributors. The Apex Court set aside the matter before the lower authorities to decide the said issue since it was not addressed by lower authorities.

Supreme Court held :

The assessee company had not operated as a mutual concern and thus, there would be no question of extending exemption from tax liability.

Acelegal Analysis : The doctrine of mutuality is premised on the theory that a person cannot make a profit from himself. An amount received from oneself, therefore, cannot be regarded as income and taxable.

One of the essential requirements of mutuality is that the contributors to the common are the same who participate in the surplus. Once such identity is established the surplus income would not be eligible to the tax on the principle that no man can make a profit out of himself.

Key Principles :

1. Three tests / conditions to prove the existence of mutuality :
 - (i) Oneness of the contributors to the fund and the recipients from the fund ;
 - (ii) entity constituted merely for the convenience and common benefit of the members.
 - (iii) Impossibility that contributors derive profit from the contributions made by them to a fund which could only be expended or returned to themselves.
2. The mutuality and non-profiteering character of a concern are to be determined in light of its actual working structure.
3. Exemptions in tax are to be put to strict interpretation.

Moreover, the surplus is the part of own contribution which is coming back. Hence, the element of "income" is missing.

22 Doctrine of mutuality is an exemption provision. In the case of *Commissioner of Customs (Import) v. M/S. Dilip Kumar And Company bearing Civil Appeal no. 3327 OF*

2007, order dt. 30 July, 2018 the apex court has ruled that exemption provisions have to be strictly construed as they grant a benefit which is otherwise not available. Therefore, any argument on the grounds of "Doctrine of Mutuality" would be governed by the tests as laid down in the instant case.

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