Privy Council Appeal No. 75 of 1946

The English and Scottish Joint Co-operative Wholesale Society Limited - - - - - *Appellant*

v.

The Commissioner of Agricultural Income-Tax, Assam *Respondent*

FROM

THE HIGH COURT OF JUDICATURE AT FORT WILLIAM IN BENGAL

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF THE PRIVY COUNCIL, DELIVERED THE 27TH APRIL, 1948

Present at the Hearing:

LORD SIMONDS
LORD NORMAND
LORD MORTON OF HENRYTON
LORD MACDERMOTT
SIR MADHAVAN NAIR
SIR JOHN BEAUMONT

[*Delivered by* LORD NORMAND]

The appellant, a society incorporated in the United Kingdom under the Industrial & Provident Societies Act, 1893, submits to review in this appeal a judgment of the High Court at Fort William in Bengal in a reference made under section 28 (1) of the Assam Agricultural Income-tax Act, 1939. By that judgment the High Court answered in the affirmative a question of law submitted by the Board of Agricultural Income-tax in relation to the assessment of the appellant for the year 1939-40. The question 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." The question is neither grammatical nor intelligible as it stands, and the Statement of Facts omits to state some of the facts regarded by the parties as material for the decision of the question which the Board seems to have intended to submit.

That question emerges clearly enough from a consideration of the proceedings which took place while the company's assessment was under consideration.

The Assam Agricultural Income-tax Act applies to all agricultural income derived from land situated in the province of Assam (section 5) and it provides by the charging section (section 3) that agricultural income tax at the rate specified in the annual Assam Finance Acts shall be charged for each financial year on the total agricultural income of the previous year. The part of the definition section (section 2) which is relevant to the present case defines agricultural income as any income derived from land used for agricultural purposes by agriculture. The

Indian Income-tax Act contains a definition of agricultural income in the same terms, but by a rule (Rule 24) made under it, " 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." The scheme of the Assam Act is to tax the remaining 60 per cent. only of the income derived from the sale of tea grown and manufactured by the seller in Assam and that result is secured by suitable provisions which need not be recited (see the explanation to section 2, the proviso to section 8 and rule 5 made under the Act). Under the Act appeals against assessment lie to the Assistant Commissioner of Agricultural Income-tax (section 24) and from him to the Commissioner (section 26). When a question of law arises in the course of any assessment the Assam Board of Agricultural Income-tax may, either of it own motion or on reference from any Agricultural Income-tax authority subordinate to it, draw up a statement of the case and refer it with its own opinion to the High Court (section 28).

The procedure which led to the reference under section 28 can be briefly summarized. While the assessment was under consideration the appellant petitioned the Board of Agricultural Income Tax, Assam to state a case to the High Court. The petition stated that the appellant society was a co-operative society incorporated under the Industrial & Provident Societies Act of 1893 and that the tea produced on its estates belonged to and was distributed entirely to its members, except certain inferior grades of dust teas which were sold in the Calcutta market, and that no profit accrued by such sales as the prices obtained were below the cost of production. The petition also stated that the question of law was whether the appellant society, owning tea estates in Assam, the produce of which is distributed only among its members, is liable to assessment to Assam Income-tax. The Board refused the prayer of the petition, but subsequently changed its view and of his own motion the Board member stated the present case. It is unfortunate that he neither consulted the parties about the facts which were necessary to raise the supposed question of law, nor about the formulation of the question of law itself. For some reason he rejected the formulation suggested in the petition and substituted a question of his own. As the accompanying statement of facts merely stated that the tea produced by the appellant society (apart from the dust tea) was sold to its members and said nothing of the price, it can be inferred that the Board member intended to submit the question whether a business carried on by a society or company, whether incorporated or not, which cultivates produce on its own land and sells it exclusively to its own members, is by its nature incapable of begetting profits as that term is understood in the Assam Agricultural Income-tax Act or, since there is no distinction on this point, the Indian or the United Kingdom Income-tax Acts.

It is unfortunate that this question is presented in an abstract and general way without any statement of facts setting out or summarizing the society's accounts for the year of computation. The statement of facts is also defective for, besides failing to refer to the price at which the tea was sold, it omits to mention certain loans made to the appellant society by its members to which the appellant's counsel attached much importance. This Board was urged by both parties to proceed with the appeal as if the statement of facts contained in the judgment of Gentle J. in the High Court were substituted for the findings of fact in the submission. It is with reluctance that their Lordships would grant such an indulgence. But, taking into account the circumstance that the present case began not long after the Assam Agricultural Income-tax Act came into operation, and making allowance for the lack of experience which may have been the cause of the inadequate presentation of the case in the submission, they will accede to the parties' request.

The facts as stated by Gentle J. are:—

> " As previously mentioned the Society is incorporated in the United Kingdom under the Industrial & 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 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 in proportion to the amount of purchases made by them from the Society; and (*f*) the remainder, if any, carried forward to the next account."

An argument was addressed to their Lordships by Counsel for the appellant in which the advances made annually by the two members to the Society were treated as contributions by the members in cash which afterwards came back to them in kind when the tea was sold to them. This is a view of the transaction which their Lordships cannot accept. The advances were a loan to the Society for the purpose of enabling it to produce tea on its own land. When the tea was produced it was sold to the lenders, and the price was set off against the amount of the loan. There was therefore a dual relationship between the appellant and its members; there was a mutual creditor-debtor relationship and there was a buyer and seller relationship. There was nothing notional about either of these relationships; they were not mere conventional machinery to give efficacy to a relationship which was in substance that of principal and agent. On the facts stated the members genuinely made a loan to the appellant; the appellant genuinely owned the land which it itself genuinely cultivated and it genuinely sold the tea at a genuine market price to its members.

The statement of facts shows that in the ordinary sense of the word profits might well result, for the proceeds of the sales might and probably did exceed the expenses of production and management and the interest on loans; that profits would result was in fact contemplated and there are rules providing for the application of the net profits. These rules are made under the Industrial & Provident Societies Act, 1893, Section 10, which contemplates that a society registered under the Act will be a profit-making concern and therefore requires that all societies registered under the Act shall make such rules. The application of net profits which may be made under the rules is in essentials not different from the application of net profits which might be made by any trading company, and it need not result in the distribution of all profits among the members of the society. Thus any net profits applied under heads (*a*), (*c*), (*d*) and (*f*) would be retained by the appellant society.

When the constitution, rules and business practice of the appellant society so closely conform to the pattern of an ordinary profit-making concern, how can it plausibly be maintained that no profits can result? The answer to this question is to be found, if anywhere, in a case under the Indian Income-tax Act decided in the High Court at Madras (reported in 3 Reports of Income Tax Cases, p. 385), in which it was held on facts indistinguishable from those stated by Gentle J. in this case that this

very society was a purely mutual co-operative society making no profits and, being within the ruling of *New York Life Insurance Co.* v. *Styles*, was not liable to be assessed to income-tax. It is on this decision that the appellants found their claim to exemption from the Assam Agricultural Income-tax Act. The High Court in the present case refused to follow the Madras decision and Gentle J. after considering it, *Styles'* case and other authorities, expressed himself thus:—" 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 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." In the *Madras* case the learned Chief Justice (3 Reports of Income Tax Cases at p. 396) expressed the opposing view, which is the view now supported by the appellant's counsel. " Before the incorporation of the Society," he says, " there existed two large co-operative societies in Great Britain, one in England known as the Wholesale Co-operative Society Ltd., and the other in Scotland known as the Scottish Co-operative Society Ltd.. They were co-operative societies of the familiar type which deliver goods to their members on a system the object of which is to eliminate the profits of the middleman as between those societies and their individual members. The goods they were to distribute to their members the Societies had of course to purchase in the market. A portion of the goods so distributed were products of Southern India, notably tea. The idea then occurred that a further elimination of outside profits could be effected by producing their own tea and other products. Accordingly the Corporation now sought to be assessed was founded with the object of acquiring and working estates in various parts of the world including Southern India to supply the two original co-operative societies with the goods they required direct.. . . . In fact the only shareholders in the English and Scottish Society are the two original co-operative societies registered in England and Scotland respectively and the object of the Society sought to be assessed is simply to run the estates, grow the produce required and ship it to the two component Societies which are its shareholders. . . . The Society cannot make taxable profits out of its own component elements, and, with that starting point established, it is to my mind immaterial that the monies that came into the hands of the ' Apex ' Society are distributed in the form in part of a dividend to the shareholders so long as those shareholders do not include any person who is not a member of the co-operative society." He therefore concluded that the case fell within the principle of *Styles'* case (14 App. Cas. 381).

The foregoing passage has been cited *in extenso* lest injustice should be done to it by condensing it in a summary. The learned Chief Justice has treated the motive for setting up the appellant society as material. There was in the case no finding about the motive, and the learned Chief Justice has assumed it; but motive is altogether irrelevant. The component members may have wished and intended that middlemen's profits should be eliminated, but the question is whether profits have in fact been earned by the appellant society which they set up. The learned Chief Justice has also failed to notice that tea grown on estates which belonged to the appellant society was not tea which the members could correctly describe as " their own tea ". But the crucial part of the judgment is the affirmation that the society could not make taxable profits out of its own component elements. The proposition is derived by the Chief Justice from *Styles'* case (*cit. supra*).

In *Styles'* case and in the other cases in which the principle established by it was applied the business carried on by the company or society sought to be taxed was mutual insurance. The essence of that kind of business (with the exception of life insurance) is that a number of persons form an association which collects from the members contri-

butions to a common fund which the members authorize the association to use for payments in indemnity of the losses assured against, for defraying the expenses of management, and for repayment to themselves of any balance. In life insurance business the association is authorized to use the common fund not for payments in indemnity of losses but for payment of sums payable on the death of a member. But in the nature of things there are no profits to be made out of a mutual arrangement to share losses, and there are no profits to be made out of a mutual arrangement to pay a sum to executors or assignees on the death of an associate. It is also to be observed that in *Styles'* and similar cases the contributors to the common fund and the participators in it are two identical bodies. The rôle of the association is to collect from the associates the contributions to the common fund and to make the payments from it in accordance with the contributors' mandate, and this mandate may be and usually is written into the constituent documents of the association, which may or may not be a corporation. The association is therefore no more than a convenient agent for carrying out what the associates might more laboriously do for themselves.

What kinds of business other than mutual insurance may claim exemption from liability to income tax under the principle of *Styles'* case need not be here considered; but their Lordships are of opinion that the principle cannot apply to an association, society or company which grows produce on its own land or manufactures goods in its own factories, using either its own capital or capital borrowed whether from its members or from others, and sells its produce or goods to its members exclusively. In the present case the appellant society is not bound by its rules to sell its tea only to its members, but it could make no difference if it were. 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.

It is next necessary to show that this view truly represents the judgments in *Styles'* case and is in accordance with judicial comments subsequently made upon them. The appellant in *Styles'* case was a life insurance company the members of which were the holders of participating policies, each of whom was entitled to a share of the assets and liable for all losses. The company collected as premiums from members a sum to cover its requirements on a calculation of the probable death rate and of the probable expenses and other liabilities. An account was taken annually and the greater part of the surplus of premiums over expenditure was returned to the policy holders as bonuses, either by addition to the sums insured or in reduction of future premiums. The remainder of the surplus 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 the participating policies was liable to be assessed to income tax as profits or gains under Schedule D. Lord Watson having distinguished the case from the earlier case of *Last* (10 App. Cas. 438) on the ground that in *Last's* case some of the policy holders were outsiders whereas in *Styles'* case the policy holders and they alone were members of the company, said " the individuals insured and those associated for the purpose of receiving their dividends, and meeting policies when they fall in, are identical; and I do not think that their complete identity can be destroyed, or even impaired, by their incorporation. The corporation is merely a legal entity which represents the aggregate of its members; and the members of the appellant company are its participating policy holders. 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 ". Lord Herschell, after stating that the Attorney-General had conceded that the fact that the persons associating themselves together for the purpose of mutual assurance had

been incorporated was immaterial, added " I think the Attorney-General was correct in thinking it immaterial that the persons then associated had been incorporated, and that a legal entity had been created distinct from the members of which it was composed. This being so I shall for the sake of simplicity consider the questions that arise as though the association were unincorporated ". He later says " Persons who agree to contribute to a common fund for mutual insurance certainly would not in ordinary parlance be regarded as carrying on a trade or vocation for the purpose of earning profit. Let us see how the so-called profit arises. It is due to the premiums which the members are required to pay being in excess of what is necessary to provide for the requisite payments to be made upon the deaths of members, and not being, as the case states they were intended to be, commensurate therewith. . . . 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 object, and accordingly their next contribution is reduced by an amount equal to their proportion of this excess. I am at a loss to see how this can be considered as a ' profit ' arising or accruing to them from a trade or vocation which they carry on ". From these quotations it appears that the exemption was based on (1) the identity of the contributors to the fund and the recipients from the fund, (2) the 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 (3) the impossibility that contributors should derive profits from contributions made by themselves to a fund which could only be expended or returned to themselves.

Cornish Mutual Assurance Co. v. *Inland Revenue Commissioners* [1926] A.C.281 was a case similar to *Styles'* case and would have had the same result but for a provision in section 53 (2) of the Finance Act, 1920, which expressly provided that the surplus arising from the transactions between mutual trading concerns and their members should be treated as profits. The only importance for present purposes of the judgments in the case is that Lord Cave L.C. took occasion to question and correct Lord Watson's opinion that the company in *Styles'* case was not carrying on a trade; it was carrying on a trade, but one in which no profits could be earned by it.

In *Liverpool Corn Trade Association Ltd.* v. *Monks* [1926] 2 K.B. 110, a company incorporated with the object of promoting the interests of the corn trade, with power to declare dividends, collected entrance fees from its members and made charges, both against members and other persons for the use of various facilities provided by it. It was found liable to income tax. The case is consistent with the view expressed by their Lordships because the shareholders and the contributors to the fund out of which dividends were paid were not identical.

Thomas v. *Richard Evans & Co. Ltd.* [1927] 1 K.B. 33 was held by Rowlatt J. to fall within the principle of *Styles'* case The association was a purely mutual assurance association and the contributors and the assured persons were identical bodies: any surplus of contributions over payments to policy holders was ultimately returned to contributors. Rowlatt J. said, " 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 *Styles'* case, there is no profit If the people were to do the thing for themselves there could 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 ". The judgment came before the House of Lords [1927] A.C. 827 and was affirmed. Lord Cave L.C. said, " Sooner or later, in meal or in malt, the whole of the company's receipts must go back to the policy holders as a class, though not precisely in the proportions in which they have contributed to them; and the association does not in any true case make a profit out of their contributions ". Lord Dunedin's judgment was to the same effect.

In *Municipal Mutual Insurance Limited* v. *Hills* 16 T.C. 430 a company formed primarily for the purpose of mutual insurance against fire also carried on employers liability and other miscellaneous insurance business. It was admitted that the fire insurance business was purely mutual and did not attract tax. But it was found as a fact that on the other side of the business the redundant part of the premiums was not returnable to the contributors of the premiums, and it was therefore held that the surplus was subject to tax. Lord Macmillan, dealing with the tax exemption of surpluses arising in the conduct of mutual insurance, said, " the cardinal requirement is that all the contributors to the common fund must be entitled to participate in the surplus and that all the participators in the surplus must be contributors to the common fund; in other words, there must be complete identity between the contributors and the participators. If this requirement is satisfied, the particular form which the association takes is immaterial."

The requirement is not satisfied in the present case: for there is no common fund to which the members of the Appellant society contribute and in which they participate.

For these reasons the appeal fails; and the Madras case in which the Appellant society was concerned must be held to have been wrongly decided.

In the course of the debate the suggestion was thrown out that on the facts and accounts of a particular year the appellant society might be in a position to maintain that a payment to its members under paragraph (*e*) of the Rules for the application of profits fell to be treated as a discount having the effect of reducing the price of the tea sold to the members and so reducing or perhaps eliminating the profits. Their Lordships are not concerned to discuss that suggestion in this appeal and express no opinion, favourable or unfavourable, upon it.

It is expedient, in view of the defects of the question, to answer it not by a simple affirmative, but by declaring that the society is not exempt from liability to Assam Agricultural Income Tax in respect of profits from the sale to its members of tea cultivated or manufactured at its Deckiajuli Estate in the province of Assam.

Their Lordships will therefore humbly advise His Majesty that the judgment of the High Court should be varied by the substitution for an affirmative answer to the question of this following answer:—" The Society is not exempt from liability to Assam Agricultural Income Tax in respect of profits from the sale to its members of tea cultivated or manufactured at its Deckiajuli Estate in the province of Assam " and that subject thereto the appeal should be dismissed.

The appellant must pay the costs of this appeal.

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In the Privy Council

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JOINT CO-OPERATIVE WHOLESALE
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Printed by His Majesty's Stationery Office Press,
Drury Lane, W.C.2.

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