Income Tax for Apartment Associations

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8th January, 2018

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For any further clarifications, interested people can reach out to Nitish Ranjan of Manohar Chowdhry & Associates on +91 9448496586 / nitishranjan@mca.co.in

PRINCIPLE OF MUTUALITY

The principle of mutuality is based on the fact that one cannot trade or profit out of oneself. Hence, income derived from oneself cannot be treated as income and thus cannot be taxed. This principle holds good for an Apartment Association ("Association") where the source of income is from its own members for whom the Association has been formed. ***For more details on the principle of mutuality, refer to Annexure – I***.

However, income generated by a society from external sources is taxable. Income generated from external sources like non-members, commercial establishments, banks (interest) etc. are taxable, unless a specific exemption has been provided under the Income Tax Act ("Act"). It has been held in a few cases that interest earned by societies from fixed deposits is taxable, as the interest earned does not fall under the ambit of the mutuality principle. ***For more details on taxability of interest earned from fixed deposits, refer to Annexure – II***.

SOURCES OF INCOME THAT ARE TAXABLE & EXEMPT

Applying the principle of mutuality to an Association, the various heads of income of an Association are split into two categories (exempt from tax & taxable):

Sources of Income Exempt From Income Tax	Sources of Income Which Are Taxable
All charges levied on members*	All charges levied on non-members
- Maintenance Charges	- Membership Fees, if any
- Interest & penalties on overdue amounts	- Interest & penalties on overdue amounts
- Rentals for usage of common amenities	- Rentals for usage of common amenities
Transfer Fees on change of ownership	Income from third parties (hoardings, cell towers etc.)
Interest on investments made in co-op banks	Interest on investments made in regular banks

INCOME TAX RATES APPLICABLE FOR ASSESSMENT YEAR 2018-19

Associations registered under KSRA

Taxable Income	Tax Rate
Up to Rs. 10,000/-	10%
Rs. 10,000 - 20,000/-	20%
Above Rs. 20,000/-	30%

Associations registered under KAOA

Taxable Income	Tax Rate
All Income will be charged at the Maximum Marginal Tax Rate	30%

Surcharge @12% of tax for income > Rs. 1 crore for Societies

Surcharge @10% of tax for income > Rs. 50 lakhs & @15% of tax for income > Rs. 1 crore for Associations under KAOA

Additional 3% on taxable amount (including surcharge) is payable towards Education Cess & Higher Education Cess.

MANDATORY TO FILE INCOME TAX RETURNS

Irrespective of an Association having income and profits or not, it is mandatory to file Income Tax Returns on an annual basis within the due date specified as per the Act in ITR-Form 5.

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ANNEXURE – I

PRINCIPLE OF MUTUALITY

The principle of mutuality has been very clearly articulated in various cases over a period of time. The following extract from the order passed by the Hon'ble Supreme Court of India in Civil Appeal No. 124 of 2007 (M/S. Bangalore Club Vs Commissioner of Income Tax), makes it very clear:

"*The principle relates to the notion that a person cannot make a profit from himself. An amount received from oneself is not regarded as income and is therefore not subject to tax; only the income which comes within the definition of Section 2(24) of the Act is subject to tax (income from business involving the doctrine of mutuality is denied exemption only in special cases covered under clause (vii) of Section 2 (24) of the Act). The concept of mutuality has been extended to defined groups of people who contribute to a common fund, controlled by the group, for a common benefit. Any amount surplus to that needed to pursue the common purpose is said to be simply an increase of the common fund and as such neither considered income nor taxable. Over time, groups which have been considered to have mutual income have included corporate bodies, clubs, friendly societies, credit unions, automobile associations, insurance companies and finance organizations. Mutuality is not a form of organization, even if the participants are often called members. Any organization can have mutual activities.*"

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ANNEXURE – II

TAX APPLICABILITY ON INTEREST EARNED FROM FIXED DEPOSITS

The applicability of income tax to interest earned from fixed deposits placed in banks (including corporate member banks of clubs) for associations, which otherwise are eligible to tax exemption on the principle of mutuality, has been established in various cases. The following extracts from the order passed by the Hon'ble Supreme Court of India in Civil Appeal No. 124 of 2007 (M/S. Bangalore Club Vs Commissioner of Income Tax), makes it very clear:

"*We may add that the assessee is already availing the benefit of the doctrine of mutuality in respect of the surplus amount received as contributions or price for some of the facilities availed by its members, before it is deposited with the bank. This surplus amount was not treated as income; since it was the residue of the collections left behind with the club. A façade of a club cannot be constructed over commercial transactions to avoid liability to tax. Such setups cannot be permitted to claim double benefit of mutuality.*"

"*In our opinion, unlike the aforesaid surplus amount itself, which is exempt from tax under the doctrine of mutuality, the amount of interest earned by the assessee from the afore-noted four banks will not fall within the ambit of the mutuality principle and will therefore, be exigible to Income-Tax in the hands of the assessee-club.*"