

Privy Council Appeal No. 31 of 1970

**Walter Fletcher on his own behalf and on behalf of
Trustees and Committee of Doctor's Cave Bathing
Club** - - - - - *Appellant*

v.

The Commissioner of Income Tax - - - - - *Respondent*

FROM

THE COURT OF APPEAL OF JAMAICA

JUDGMENT OF THE LORDS OF THE JUDICIAL COMMITTEE OF
THE PRIVY COUNCIL, DELIVERED THE 6TH OCTOBER 1971

Present at the Hearing :

LORD GUEST
LORD WILBERFORCE
LORD SIMON OF GLAISDALE

[*Delivered by LORD WILBERFORCE*]

The question in this appeal is whether the Doctor's Cave Bathing Club at Montego Bay, Jamaica, represented by the Appellant, is assessable to income tax upon the profit element contained in receipts from certain hotels, whose guests have the right to use the club. The gross receipts from this source in the relevant year of assessment were £1,720; the profit attributable to them is £472 and the amount of income tax payable on the Respondent's contention is £145.

The case was treated by the Court of Appeal of Jamaica as one in which an appeal to Her Majesty lay as of right: the provision applied being s.110(1)(a) of the Constitution of Jamaica, which allows an appeal against final decisions in civil proceedings "where the matter in dispute on the appeal to Her Majesty in Council is of the value of £500 or upwards, or where the appeal involves directly or indirectly a claim to or question respecting property or a right of the value of £500 or upwards."

A preliminary objection was taken by the respondent that the appeal was incompetent, since the necessary condition was not fulfilled: the "matter in dispute" in his submission was the appellant's liability for income tax in the sum of £145. The appellant contended that the "matter in dispute" was the manner in which the sum of £1,720 was to be treated for purposes of income tax—whether as a trading receipt or in some other manner. If it is to be treated as a trading receipt there is no dispute as to the amount of tax payable. This submission was accepted by the Court of Appeal.

Their Lordships are however of the opinion that the appeal is not competent under the provisions of s.110(1)(a). Whether an appeal is competent under a provision such as this (which has existed and exists in the same form in many other jurisdictions) must be decided upon the basis of the judgment against which it is sought to appeal, and depends

upon whether that judgment affected the interest of the party prejudiced by it to an extent not less than the specified amount. This was clearly laid down by this Board in *Macfarlane v. Leclaire* (1862) 15 Moo. 181, which has repeatedly been followed and applied. In a case involving liability for tax where a taxpayer desires to appeal, the relevant amount is that which the taxpayer has been adjudged liable to pay, and (quite apart from the fact that, if any other figure were to be looked at, the relevant figure appears to be that of the profit rather than that of the gross receipts) it is impermissible to go behind the sum claimed to some other figure upon which the ultimate liability may depend. As an analogy, if the claim were one for commission on a transaction, the relevant amount must be the amount of the commission and not that of the transaction which gives rise to it. It is equally impermissible to seek to inflate the liability for tax which was the subject of the proceeding by adding to it the amount of tax liabilities for subsequent years. The second limb of s.110(1)(a) being inapplicable, the initial words of the section itself make it clear that it is only the amount in dispute in the proposed appeal that is relevant. The amount in dispute in the present appeal being £145, no appeal lay as of right and the appeal as presented was incompetent.

Their Lordships, having announced that they would humbly advise Her Majesty accordingly, permitted the appellant to lodge a Petition for special leave to appeal. Their Lordships humbly advised Her Majesty that this should be granted, and proceeded to hear the appeal on its merits.

The Doctor's Cave Bathing Club is a members' club in the Parish of St. James. It owns an attractive bathing beach, to which various amenities have been added. The Club appears in the first instance to have been an ordinary members' club, to which members paid subscriptions; they enjoyed the right to bathe. Apart from residents of the parish of St. James, who had special rights, any person other than a member who wished to bathe had to buy a ticket for 3s. This extended to persons staying at the local hotels: for convenience, blocks of tickets were bought by the hotels and resold at the same price to the hotel guests. This method was found to have disadvantages; so in 1956 some of the hotels made an arrangement with the Club, through its committee, that a new class of members should be created, called "hotel members", and the rules of the Club were amended so as to provide for them. This revision provided that hotel members should be "hotels in Montego Bay which pay to the Club subscriptions based on the audited house count of its guests . . . and their resident guests shall be entitled to the use and amenities of the Club." The reference to the "house count" meant that the hotel's auditors had to submit a certificate stating the number of guests at the hotel over a specified period, and the hotel paid the Club 2s. per head in respect of each such guest. The rules also provided that ordinary and hotel members should have proprietary rights in the Club, but that only ordinary members should have voting rights.

In 1963 a question arose as to the Club's liability for income tax in respect of its receipts from hotels and on 12th June 1963 the Income Tax Appeal Board decided against the Club. From the minute of decision it appears that the Club had relied on the mutuality principle, but the Board considered that this did not apply because the hotels had no right to vote and so were not truly members. Thereupon, on 14th October 1963, the rules were re-amended to their present form. The main alterations were that the hotel members were given a right to vote, each hotel member having one vote only, and that hotel members were to pay an annual subscription of £1 10s. (as in the case of ordinary members) and in addition an aggregate amount based on the audited house count.

The present organisation is therefore that there are ordinary members paying £1 10s. or £3 for family membership, paying visitors who buy tickets and hotel members paying £1 10s. subscription plus 2s. per guest on the audited house count. Guests in member hotels pay nothing to the Club and no specific charge for bathing appears to be made in their hotel bills. They pay an inclusive rate for all the hotel facilities.

The relative importance of the various elements appears from some exhibited accounts. For 1963, ordinary members' subscriptions were £1,365—indicating a probable membership of between 450 and 900 depending on the number of family members. Hotel membership subscriptions were £8,252 (the greater part of which was paid before the change of rule). Admission tickets brought in £4,958. There were only three or four hotel members.

These are the facts upon which the Commissioner has sought to tax the "profit" element in the relevant proportion of the hotel membership subscriptions. His contention is essentially, that these payments are trading receipts of the Club, and must be brought into the computation of the Club's profits, in the same way, essentially, as the Club's revenue from tickets of admission. The appellant's contention is that the Club should be regarded as an ordinary members' club and the hotel subscriptions treated in the same way as the subscriptions of ordinary members, *i.e.*, as a contribution to a common fund set up to preserve and improve the amenities of the club.

Cases in which groups of persons making contributions towards a common purpose have been held not liable for tax on any surplus over expenditure, fall under a number of heads. The expression "the mutuality principle" has been devised to express the basis for exemption of these groups from taxation. It is a convenient expression, but the situations it covers are not in all respects alike. In some cases the essence of the matter is that the group of persons in question is not in any sense trading, so the starting point for an assessment for income tax in respect of trading profits does not exist. In other cases, there may be in some sense a trading activity, but the objective, or the outcome, is not profits, it is merely to cover expenditure and to return any surplus, directly or indirectly, sooner or later, to the members of the group. These two criteria often, perhaps generally, overlap; since one of the criteria of a trade is the intention to make profits, and a surplus comes to be called a profit if it derives from a trade. So the issue is better framed as one question, rather than two: is the activity, on the one hand, a trade, or an adventure in the nature of trade, producing a profit, or is it, on the other, a mutual arrangement which, at most, gives rise to a surplus?

The three main fields in which the mutuality principle has been applied are insurance, rating and clubs. In the insurance cases a group of persons form a common pool by contributions, which pool is then used to indemnify against losses, in the case of risk insurance, or, in the case of life insurance, to pay insurance benefits on death. The analysis of these arrangements which is now accepted is that although there may be a trade, there are no profits (see *Cornish Mutual Assurance Co. v. I.R.C.* [1926] A.C. 281, 286, per Lord Cave L.C.; *English & Scottish Joint Co-operative Wholesale Society Ltd. v. Commissioner of Agricultural Income Tax, Assam* [1948] A.C. 405, 416, "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").

The rating cases are exemplified by the *Glasgow Corporation Water Commissioners* case (1875) 1 T.C. 28. The purpose of assessment to water rate was held to be to obtain a good supply of water for Glasgow. "In so assessing themselves they [the citizens] had not in view certainly

to make profit by the undertaking. On the contrary, what they have distinctly in view is, to pay money in order to obtain this particular benefit". (p. 48).

The classic case as to members' clubs is *The Carlisle & Silloth Golf Club v. Smith* (1912) 6 T.C. 48, which brings out the distinction between members, contributing on a mutual basis in order to secure an amenity, and outsiders admitted to participate in amenities on payment, with whom the Club is trading. The central passage from the judgment of Hamilton J. is apposite to the present case.

"I think, therefore, that at the outset the club has, for considerations sufficient in its own view, annexed to its ordinary enterprise of a golf club the rendering of services systematically to strangers for the purpose of obtaining, among other advantages to itself, the revenue that those strangers provide. It is not a case where, thanks to the relations of membership or family bonds, people club together and reduce the common expenditure on some common object by contributions which they fix roughly with some reference to the cost. It seems to me that it is not a case in which the members as an aggregate (for they are not incorporated) dispose of their surplus because they have no necessity to consume it; it is a case it seems to me at the outset in which this aggregate of gentlemen, who may for practical purposes be treated as one person, annexed to their club for the purposes of recreation an enterprise which is separate from it and which results in pecuniary receipts to themselves."

A simple example where (as is normal) there is no element of trading is that of *The Bohemians Club of Melbourne* (1918) 24 C.L.R. 334. There a club was described by Griffith C.J. as a voluntary association of persons who agree to maintain for their common personal benefit, and not for profit, an establishment the expenses of which are to be defrayed by equal contributions of an amount estimated to be sufficient to repay their expenses. (l.c. p. 337).

His Honour there refers to equal contributions, but this is not an essential feature. Many clubs collect subscriptions of different amounts according to the use expected to be made of the facilities, or to age, or personal circumstances, and this is consistent with "mutuality". So here it was argued that the mere fact that the hotel members paid higher (much higher) contributions is not inconsistent with the club being a normal mutual club.

At what point then does the relationship of mutuality end and that of trading begin? That is the critical and difficult question here. The proposition of the appellant is that so long as there is common membership—each member having membership rights, *i.e.*, at least the right to vote, and a proprietary share in assets, mere inequality of rights or obligations, does not take the case out of mutuality and into trading. Here, it is claimed, at least since the revision of 1963, the hotels were fully members in this sense: the fact that they were individually engaged in trading does not affect the nature of their interest in the Club, which must depend upon the Club's rules. This argument was accepted and attractively stated by Edun J. at first instance.

Their Lordships are of opinion that except in the simplest cases, no single criterion is likely to be decisive. They accept that mutuality is not necessarily excluded by the fact that some "members" are corporate bodies, or even corporate bodies engaged in trade. But the relevance of facts such as these must vary with the nature of the activity. In the case of insurance, they are of little or no weight, since companies, and

trading companies, can just as naturally and appropriately engage in a mutual insurance scheme as individuals. And in the field of rating the same is true: a rate payer can just as well be a trading corporation as an individual. In social relationships or where recreation is involved the position may be different: the presence among "members" of trading companies at least suggests the necessity of enquiry as to the reason for and nature of their participation. In the present case, it may be agreed that the fact that hotels are not themselves potential bathers may be immaterial: but yet the enquiry is open whether the relationship of the aggregate of the ordinary bathing members with the hotels is truly one of mutuality, or is rather of a trading character. It is necessary therefore to seek other indications pointing in one direction or the other.

Their Lordships do not consider that it is legitimate to have regard to some "substance" of the arrangement—in the sense that it is permissible to look through the hotel members to their guests and to conclude that the hotel subscriptions come "in reality" from the hotel guests. Such a conclusion could only be justified by departing from the finding of the trial judge that hotel guests do not make payments to the Club.

But on the other hand their Lordships cannot regard as decisive the mere fact that the hotels are described as "members" and have rights of the same kind that other members have. It may not be an essential condition of mutuality that contributions to the fund and rights in it should be equal; but if mutuality is to have any meaning there must be a reasonable relationship, contemplated or in result, between what a member contributes and what, with due allowance for interim benefits of enjoyment, he may expect or be entitled to draw from the fund: between his liabilities and his rights. The hotel members may be said, through the advantages gained for their guests, to derive current advantages commensurate with their subscriptions; but as regards any surplus, the disparity between their interest and that of ordinary members is one of substantial scale. Each hotel has one share: the hotels in aggregate have 3 (or 4) shares against 450–900 of the ordinary members. Similarly as to votes—one per hotel and one per each ordinary member. The ordinary members as a group have an overwhelmingly greater interest in the regularly earned surplus—admittedly not in practice distributed, but which could be distributed if the ordinary members wished, and which, if not distributed, goes to increase the value of property which is predominantly theirs.

The matter may be looked at in another way. Originally the Club had the ordinary characteristics of a club: like the Carlisle & Silloth Golf Club, the members paid subscriptions and sold tickets to visitors, including guests in hotels. Undoubtedly at this stage they, as a group, were trading, for profit, with the visitors and guests. Then, when the beach hotels took over the payment of subscriptions, and paid them on behalf of the guests, the position was held, by the Income Tax Board, to be the same: their Lordships consider this decision to have been correct. The ordinary members as a group were trading, for profit, with the hotels. Was then a radical transformation brought about in 1963 when the hotels became subscription paying members—paying (in addition to the house count charge) £1 10s. per annum and entitled each to one vote? In their Lordships' opinion so to conclude would amount to a distortion, if not a mockery, of the mutuality principle. The hotels may have become members in 1963; but side by side with their membership there continued the pre-existing relationship with the ordinary members which was essentially a trading relationship, similar to that with outside visitors. What is, and always has been, of significance is not the fact of membership or non-membership but the nature of the transactions: if these were trading transactions, the

addition of membership makes no difference. (See *Ayrshire Employers Mutual Insurance Association Ltd. v. C.I.R.* (1946) 27 T.C. 331—the converse case: and p. 347 per Lord Macmillan).

Their Lordships therefore are of opinion that the appeal fails. It is, accordingly, not necessary to consider the Commissioner's alternative contention, based on s. 10 (1) of the Income Tax Law No. 59 of 1954, that he is entitled to disregard the change of rules made on 14th October 1963 as being an "artificial or fictitious" transaction.

Their Lordships will humbly advise Her Majesty that the appeal should be dismissed. The appellants must pay the costs of the appeal.

In the Privy Council

WALTER FLETCHER ON HIS OWN
BEHALF AND ON BEHALF OF
TRUSTEES AND COMMITTEE OF
DOCTOR'S CAVE BATHING CLUB

v.

THE COMMISSIONER OF INCOME
TAX

DELIVERED BY
LORD WILBERFORCE