

**IN THE INCOME TAX APPELLATE TRIBUNAL
“C” BENCH : BANGALORE**

**BEFORE SHRI SUNIL KUMAR YADAV, JUDICIAL MEMBER AND
SHRI JASON P BOAZ, ACCOUNTANT MEMBER**

ITA No.543/Bang/2017
Assessment year : 2013-14

Deputy Commissioner of Income Tax, Circle-6(1)(1), Bengaluru, Room No.237, 2 nd Floor, BMTC Building, 80 feet road, Koramangala, Bengaluru – 560 001.	Vs.	M/s. Shriram Chits (Karnataka) Pvt. Ltd., No.259/31, 1 st Floor, 10 th Cross, Wilson Garden, Bengaluru-5600278. PAN:AACCS 2078 R
Appellant		RESPONDENT

Revenue by	:	Shri. Pradeep Kumar, Addl. CIT
Assessee by	:	Smt. Lalitha Kameshwaran, Advocate

Date of hearing	:	22.11.2017
Date of Pronouncement	:	28.11.2017

ORDER

Per Sunil Kumar Yadav, Judicial Member

This appeal is preferred by the Revenue against the order of CIT(A), *interalia*, on the following grounds:

1. *The order of the CIT(A) is opposed to law and the facts and circumstances of the case.*
 2. *On the facts and in circumstances of the case, the CIT(A) erred in deleting the disallowance of Bid Loss Claimed in the computation of total income in addition to BID Loss claimed in the Profit & Loss account, without appreciating that the amount of Bid Loss claimed is incorrect as per the provisions of Section 145(1) of the I. T. Act. Further, it is not in consonance with Board's Notification No.SO 69(E) dt. 25.01.1996 and Accounting Standard AS 22 of ICAI.*
 3. *For these and such other grounds that may be urged at the time of hearing, it is humbly prayed that the order of the CIT(A) in so far as it relates to the above grounds may be reversed and that of the Assessing Officer be restored.*
 4. *The appellant craves leave to add, alter, amend or delete any of the grounds that may be urged at the time of hearing of the appeal.*
2. During the course of hearing, the learned counsel for the assessee invited our

attention that the impugned issue is squarely covered by the order of the Tribunal in the assessee's own case for the assessment years 2010-11 to 2012-13 in which the Tribunal has followed the judgment of various High Courts and Apex Court while allowing the relief to the assessee. The assessee has also placed reliance upon the judgment of the Apex Court in the case of Taparia Tools Ltd., JCIT [2015] 372 ITR 605 (SC) in which the Tribunal has examined the similar issue and finally concluded that assessee is entitled to the deduction of the entire expenditure in the year in which the amount was actually paid.

3. The learned DR placed the reliance upon the order of the AO.

4. Having carefully examined the orders of the lower authorities and judgments referred to by the parties and the Tribunal's order in the assessee's own case, we find that identical issue was raised before the Tribunal. The Tribunal has adjudicated the issue in the light of various judicial pronouncements of different High Courts and Apex Court and after following the same, the Tribunal decided the issue in favour of the assessee by holding that Bid Loss incurred on account of lifting the chit in the capacity of subscriber to chit is allowable in full in the year in which the chit was auctioned. Relevant observation of the Tribunal is extracted hereunder for the sake of reference:

"6. We have heard the rival submissions and perused the material on record. The issue in appeal pertains to whether the loss incurred on account of bidding the chit is allowable in full in the year of bidding the chit. The loss represents difference between the face value of the chit and the bid value. This difference was claimed as loss in the computation of the total income, whereas the AO was of the opinion, that this loss should be apportioned over the period of the chit. The identical issue had come up before the Hon'ble Madras High Court in the case of M/s Bilahari Investments Pvt.Ltd. Vs CIT, reported 288 ITR 39, wherein the Hon'ble Madras High Court after distinguishing the decision of the Hon'ble Supreme Court in the case of Madras Industrial Investment Corporation Ltd Vs CIT (197) 225 ITR 802 also following the decision of the Hon'ble Andhra Pradesh High Court in the case of CIT Vs Kovur Textiles & Co. reported in 136 ITR 61, held as under;

"The Andhra Pradesh High Court in CIT vs. Kovur Textiles & Co. (1982) 136 ITR 61 (AP) found that the assessee company subscribed to a chit fund by joining in a chit group and after paying few instalments, the assessee bid the chit and claimed the difference between the chit amount and the price

for which it was bid as a business loss. On the factual backdrop, the Andhra Pradesh High Court held that the loss incurred by the assessee in the process of bidding the chit amount could be allowed as a business loss.

Of course, the Punjab & Haryana High Court in *Soda Silicate & Chemical Works vs. CIT (1989) 179 ITR 588 (P&H)* took a contra view that where the assessee secured a chit on discount and claimed deduction of discount amount while computing its assessable income, the loss incurred thereon was not incidental to the business and therefore, disallowed the assessee's claim during the year in question.

We are unable to agree with the decision of the Division Bench of the Punjab & Haryana High Court in *Soda Silicate & Chemical Works vs. CIT* cited supra. The Punjab & Haryana High Court held that the discount amount is not allowable as business loss on the ground that the transaction involved did not give rise to any income assessable to income-tax, nor any revenue loss in respect of which any deduction could be claimed. The judgment of the Punjab & Haryana High Court has no relevance to the facts of the present case, as, in this case, business loss occurred during the previous year relevant for the assessment year and the discount is found to be connected with the business activities of the assessee, whereas in the case before the Punjab & Haryana High Court, on facts, it was found that the discount is not connected with the business of the assessee. On the other hand, the facts of the present case are similar to that of the case before the Andhra Pradesh High Court, viz., *CIT vs. Kovur Textiles & Co. (supra)* and hence, we agree with the view taken by the Andhra Pradesh High Court.

The Tribunal relied on the decision of the Supreme Court in *Madras Industrial Investment Corporation Ltd. vs. CIT (supra)* and held that the dividend is taxable and discount is allowable both during the accounting year proportionately. In *Madras Industrial Investment Corporation's* case cited supra, the assessee company issued debentures at a discount and it incurred a liability to pay a larger amount than what it had borrowed. The liability to pay the discounted amount over and above the amount received for the debentures is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities. Then, while deciding the question whether such a liability is an expenditure or not, the apex Court held that the liability to pay discounted amount over and above the amount received for the debentures is a liability incurred by the company for the purposes of its business in order to generate funds for its business activities and therefore, it is an expenditure. The apex Court also held that it is an expenditure deductible only proportionately during the period of assessment years.

The decision of the apex Court in *Madras Industrial Investment Corporation's* case (supra), as rightly pointed out by learned counsel for the appellants/assesseees, is distinguishable on the facts of the case.

The present case relates to the chit fund transaction. The chit is a kind of savings scheme. In a chit scheme, a specific number of individuals come together to pool a specific amount at periodic intervals. Usually, the number of individuals and the number of periods will be the same. At the end of

each period, there will be an auction of the money. The members of the chit will participate in this auction for the pooled money during that interval. The bid amount will be divided by the number of members and thus determining per head contribution during that period. Usually the discount, namely, the sum of money which the prized subscriber is required to forgo, will continue to decrease over periods. The person getting money in the last period will receive the full scheme amount.

On the other hand, the debenture is an instrument of debt executed by the company acknowledging its receipt to repay the same at a specified rate and also carrying interest. It is in sum and substance a certificate of loan or a bond evidencing the fact that the company is liable to pay a specified amount with interest. A debenture is unsecured in the sense that there are no liens or pledges on specific assets. It is, however, secured by all properties not otherwise pledged. In the case of bankruptcy, the debenture-holders are considered general creditors. When a company issues debentures at a discount, the debenture-holders are required to pay a lesser sum than the face value and the company incurs a liability to pay a larger amount than what it has borrowed, at a future date. The liability to pay the discounted amount over and above the amount received for the debentures is a liability which has been incurred by the company for the purposes of its business in order to generate funds for its business activities.

Insofar as debenture is concerned, the benefit to be derived from the amount borrowed will continue till the debenture is redeemed and the liability is a continuing liability which should be spread over the period of the debentures. But, in a chit transaction, a member of the chit will forgo the discount when he bids the chit. The discount amount varies in each period and it has no connection or relevance to the liability to pay future instalments. In other words, in chit transaction the discount is based on the bid and the bid loss has no relevance to the liability for future instalments, whereas in the case of discount on debentures, it is not based on any bid loss, but it spreads over the period of life of the debentures. In the case of debentures, it is a case of receipt, while in the case of chit transaction, it is an amount paid followed by the encashment of the chit amount at an early date with the promise to pay the remaining instalments. In this view of the matter, the decision of the apex Court in Madras Industrial Investment Corporation vs. CIT (supra) is not applicable as in the instant case the discount arises out of a chit transaction, whereas the apex Court dealt with the discount on the issue of debenture.

A five-Judge Bench of the Kerala High Court in Janardhana Mallan vs. Gangadharan AIR 1983 Ker 178 (FB) : (1985) 58 Comp Cas 390 (Ker)(FB) held that on entering into the chitty agreement a debt is not incurred by the subscriber for the amount of all the future instalments, but it is a promise to discharge the contractual obligation, whether the prize is drawn or not or the prize amount is received or not. It is also held that but for such obligation there will be no difference between the liability of the prized subscriber and the non-prized subscriber and both arise out of the same contract and that since both profit and loss arise simultaneously on the date of prize drawn

itself, the question of incurring fresh obligation to pay future subscription does not arise. Therefore, the subscriber is entitled to deduction of discount as business loss in the accounting year in which it occurred.

As observed earlier, in the chit transaction there is only a promise on the part of the assesseees to discharge the contractual obligation. Further, the assessee companies following the mercantile system of accounting as statutorily required under the Companies Act, have to account for their income or loss as per the mercantile system of accounting and not otherwise. In other words, the income or loss of the assesseees accruing during the relevant accounting year has to be considered for the purpose of income-tax assessment. When the assesseees are in the business of subscribing to chits and deriving income out of it during a particular year, it is not possible or permissible to defer its assessability till the completion of the entire cycle of the chit.

At this juncture, it is apt to refer to ss. 5 and 145 of the IT Act :

"5. Scope of total income.—(1) Subject to the provisions of this Act, the total income of any previous year of a person who is a resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year; or

(c) accrues or arises to him outside India during such year :

Provided that, in the case of a person not ordinarily resident in India within the meaning of sub-s. (6) of s. 6, the income which accrues or arises to him outside India shall not be so included unless it is derived from a business controlled in or a profession set up in India.

(2) Subject to the provisions of this Act, the total income of any previous year of a person who is a non-resident includes all income from whatever source derived which—

(a) is received or is deemed to be received in India in such year by or on behalf of such person; or

(b) accrues or arises or is deemed to accrue or arise to him in India during such year.

Explanation 1.—Income accruing or arising outside India shall not be deemed to be received in India within the meaning of this section by reason only of the fact that it is taken into account in a balance sheet prepared in India.

Explanation 2.—For the removal of doubts, it is hereby declared that income which has been included in the total income of a person on the basis that it has accrued or arisen or is deemed to have accrued or arisen to him shall not again be so included on the basis that it is received or deemed to be received by him in India."

"145. Method of accounting.—(1) Income chargeable under the head 'Profits and gains of business or profession' or 'Income from other sources' shall, subject to the provisions of sub-s. (2), be computed in accordance

with either cash or mercantile system of accounting regularly employed by the assessee.

(2) The Central Government may notify in the Official Gazette from time to time accounting standards to be followed by any class of assesseees or in respect of any class of income.

(3) Where the AO is not satisfied about the correctness or completeness of the accounts of the assessee, or where the method of accounting provided in sub-s. (1) or accounting standards as notified under sub-s. (2), have not been regularly followed by the assessee, the AO may make an assessment in the manner provided in s. 144."

*A conjoint reading of the above provisions of law makes it clear that all income received or deemed to be received or accrues or arises during the previous year shall form part of the total income of the assessee and such income shall be computed in accordance with the accounting system which the assessee is regularly following. Here, on the facts of the case, the authorities have found that the assesseees are following the mercantile system of accounting. The mercantile system of accounting means, as discussed in *Shiva Prasad Gupta vs. CIT AIR 1929 All 823*, the amounts that have become recoverable are shown as the income actually received and the liabilities incurred are shown as amounts actually disbursed in any particular year. Therefore, when the assesseees are following the mercantile system of accounting, in which entries are posted in the books of account on the date of the transaction, that is, on the date on which rights accrue or liabilities are incurred irrespective of the date of payment, they have to account for their income or loss as per the mercantile system of accounting and not otherwise. Therefore, as rightly found by the CIT(A), the income derived during a particular previous year by way of chit dividend has to be reckoned and assessed as income of that year following the principles of mercantile/accrual system of accounting, particularly when the assesseees are companies following the mercantile system of accounting.*

The chit transaction is governed by the provisions of the Chit Funds Act. In view of the non obstante clause found in s. 3 of the Chit Funds Act, 1982, namely,

"3. Act to override other laws, memorandum, articles, etc.—Save as otherwise expressly provided in this Act,—

(a) the provisions of this Act shall have effect notwithstanding anything to the contrary contained in any other law for the time being in force or in the memorandum or articles of association or bye-laws or in any agreement or resolution whether the same be registered, executed or passed, as the case may be, before or after the commencement of this Act; and

(b) any provision contained in the memorandum, articles, bye-laws, agreement or resolution aforesaid, shall, to the extent to which it is repugnant to the provisions of this Act, become or be void, as the case may be,"

the definitions of the expressions, discount, dividend, prize amount, as extracted above, will prevail over the similar definitions as found in the IT Act, because a non obstante clause is generally appended to a section with a view to give the enacting part of the section in case of conflict, an

overriding effect over the provision in the same or other Act mentioned in the non obstante clause [vide : State of Bihar vs. Bihar Rajya M.S.E.S.K.K. Mahasangh (2005) 9 SCC 129]. Therefore the discount is not an interest payable on the prized amount, but it is a loss.

As already observed, in chit transaction there is no correlation between the discount amount and the future instalments. Further, the measure of future instalments does not depend upon the prized amount or the discount, nor the discount is an expenditure to be incurred in future. The discount is not a deferred expenditure for which payment has been made, or a liability incurred, but the discount is carried forward on the presumption that it will be of benefit over a specific period. In the chit transaction, there is no deferred benefit, which is construed to mean the benefit deferred to a year subsequent to the accounting year and hence, the question of deferred expenditure does not arise.

That apart, the provisions of the Chit Funds Act require the prized subscriber to furnish security for future instalments. Therefore, neither the enforceability of the right to receive the dividend, nor that of the obligation to pay the discount could be deferred and both accrue instantaneously. Hence, the discount is allowable in the very same year of accrual. In this view of the matter, the dividend has to be taxed in the year of accrual; so also, the discount has to be allowed in full in the year of accrual itself. The Tribunal is right in rejecting the completed contract method of accounting adopted by the assessee and at the same time, it is not correct in holding that the discount should be allowed spreading it over the remaining period of the chit on a proportionate basis”.

Respectfully following the above decision of the Hon'ble Madras High Court and the Co-ordinate Bench decision in the assessee's own case cited supra, we hold that the bid loss incurred on account of lifting the chit in the capacity of subscriber to chit is allowable in full in the year in which the chit was auctioned. Therefore, we dismiss the appeals filed by the revenue.”

5. The identical issue was also examined by the Apex Court in the case of Taparia Tools Ltd., Vs. JCIT (supra) in which their Lordship has examined the issue and held that the assessee is entitled for deduction of the entire expenditure. The relevant observation of the Hon'ble Supreme Court is extracted hereunder:

“17. What follows from the above is that normally the ordinary rule is to be applied, namely, revenue expenditure incurred in a particular year is to be allowed in that year. Thus, if the assessee claims that expenditure in that year, the Income-tax Department cannot deny the same. However, in those cases where the assessee himself wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of “matching concept” is satisfied, which up to now has been restricted to the cases of debentures.

18. *In the instant case, as noticed above, the assessee did not want spread over of this expenditure over a period of five years as in the return filed by it, it had claimed the entire interest paid upfront as deductible expenditure in the same year. In such a situation, when this course of action was permissible in law to the assessee as it was in consonance with the provisions of the Act which permit the assessee to claim the expenditure in the year in which it was incurred, merely because a different treatment was given in the books of account that cannot be a factor which would deprive the assessee from claiming the entire expenditure as a deduction. It has been held repeatedly by this court that entries in the books of account are not determinative or conclusive and the matter is to be examined on the touchstone of the provisions contained in the Act (See Kedarnath Jute Manufacturing Co. Ltd. v. CIT*; Tuticorin Alkali Chemicals and Fertilizers Ltd. v. CIT**; Sutlej Cotton Mills Ltd. v. CIT*** and United Commercial Bank v. CIT#.)*

6. We have also carefully examined the order of the CIT(A) and we find that CIT has adjudicated the issue in consonance with the order of the judgments of the High Court and Apex Court and accordingly we confirm the same.

7. In the result, appeal of the Revenue stand dismissed.

Pronounced in the open court on 28th November, 2017.

Sd/-
(JASON P BOAZ)
Accountant Member

Sd/-
(SUNIL KUMAR YADAV)
Judicial Member

Place : Bangalore
Dated : 28/11/2017
/NShylu/

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| 1 | Appellant | 2 | Respondent |
| 3 | CIT(A)-II Bangalore | 4 | CIT |
| 5 | DR, ITAT, Bangalore. | 6 | Guard file |

By order

Sr. Private Secretary,
ITAT, Bangalore.